THE LAW REFORM COMMISSION OF HONG KONG

SUPPLY OF GOODS SUB-COMMITTEE

CONSULTATION PAPER

CONTRACTS FOR THE SUPPLY OF GOODS

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December 2000

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The Sub-committee would be grateful for comments on this Consultation Paper by 28 February 2001. All correspondence should be addressed to:

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THE LAW REFORM COMMISSION OF HONG KONG

Consultation paper on contracts for the supply of goods

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Preface

1. The Law Reform Commission issued a report on *Sale of Goods and Supply of Services* in February 1990.[1] Based on the recommendations in the report, three ordinances, namely, the Sale of Goods (Amendment) Ordinance 1994,[2] the Supply of Services (Implied Terms) Ordinance (Cap 457) and the Unconscionable Contracts Ordinance (Cap 458) were enacted in 1994.

2. The Sale of Goods (Amendment) Ordinance 1994 amended the Sale of Goods Ordinance (Cap 26). The major amendments included a new definition of "merchantable quality", and clarification of a buyer's right to reject defective goods where he has not had a reasonable opportunity to examine the goods, even after a sub-sale of the goods. The Unconscionable Contracts Ordinance (Cap 458) empowers courts to give relief in contracts for sale of goods or the supply of services where the contracts are found to be unconscionable.

3. The Supply of Services (Implied Terms) Ordinance (Cap 457) makes a contract for the supply of services subject to certain statutory implied terms. A contract for the supply of services is defined, among others, as a contract under which a person agrees to carry out a service, whether or not goods are also –

(i) transferred or to be transferred; or
(ii) bailed or to be bailed by way of hire,

under the contract, and whatever is the nature of the consideration for which the services are to be carried out.[3]

4. The effect of this definition is that the "service" element of contracts for services is caught by Cap 457 whether or not there is any "goods" element accompanying the supply of the service. The implied terms under Cap 457 (as to care and skill, time for performance and consideration) apply only to the "service" element under such contracts. Cap 26 does not apply to the goods element (if any) under such contracts. It is because Cap 26 only covers goods sold under a contract of sale which is a contract with monetary consideration where the main object of the contract is to transfer, or to agree to transfer, the property in goods to the buyer. In other words, there is no statutory implied term which covers the "goods" element where goods are supplied as part of a contract for the supply of services.

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1 (Topic 21).
2 Ord No 85 of 1994.
3 See section 3 of Cap 457.

5. Apart from contracts for the supply of services with ancillary goods mentioned above and contracts of sale, there are other types of contracts for the supply of goods under which property or possession of goods passes. Indeed, there are various types of contracts for the supply of goods (other than sale). For example, there are contracts of barter, contracts of hire, hire purchase agreements, etc. However, as regards implied undertakings by suppliers of goods, they are implied under Cap 26 only in contracts of sale but not other types of contracts for the supply of goods. Hence there are no statutory implied undertakings for contracts for work and materials, contracts of barter, contracts of hire, hire purchase agreements, etc. These contracts are regulated by common law. Although academics and the courts have supported the implication of those obligations in contracts for supply of goods (other than sale), we will see in the following chapters that there remain significant gaps in the law.

Terms of reference

6. The Secretary for Justice and the Chief Justice have thought it appropriate to review the law governing contracts for the supply of goods and they have referred the topic to the Law Reform Commission with the following terms of reference:

> *"To review the law governing contracts for the supply of goods and to consider such reform as may be necessary".*

7. On 4 June 1998, the Law Reform Commission appointed a sub-committee to examine the current state of law and to make recommendations. The members of the Sub-committee are:

Hon Mr Justice Bokhary PJ (Chairman)	Court of Final Appeal
Mr Eric Cheung	Assistant Professor Department of Professional Legal Education University of Hong Kong
Mr Joseph Fok	Senior Counsel
Mr Paul Kent	Assistant Professor Department of Building & Real Estate Hong Kong Polytechnic University
Mr K M Li	Deputy Chief Executive Consumer Council
Mr Richard Luk	Principal Assistant Secretary Economic Services Bureau

Mr David Murray	Group Legal Manager The Dairy Farm Group
Mr Steve Page	Deputy Managing Director Wayfoong Finance Limited
Mr Adrian Wong	Consultant Messrs Chao & Chung
Mr Byron Leung	Secretary to the Sub-committee

Layout of this Paper

8. Chapters 1 – 8 are mainly concerned with contracts for the supply of goods other than sale and in particular, with the terms to be implied in them. There are various types of terms which can be implied in contracts for the supply of goods. In these chapters, we only discuss the implied obligations of suppliers in respect of the goods. We review the existing law on supply of goods in Hong Kong and then consider the positions of other jurisdictions to examine how Hong Kong's law on supply of goods may be improved.

9. We discuss in Chapter 1 the existing provisions regulating implied terms in contracts for sale of goods and the need for further legislation for other kinds of supply of goods (the "Recommended Legislation"). In Chapter 2, we explain the expression "contracts for the supply of goods". In Chapters 3 to 6, we discuss the implied terms to be put into the Recommended Legislation, namely, implied terms about title, correspondence with description, implied terms about quality and fitness, and correspondence with the sample. We then discuss the remedies for breaches of the statutory implied terms in the Recommended Legislation in Chapter 7. In Chapter 8, we discuss the exclusion of liability and the control of it.

10. In Chapter 9, we discuss various issues concerning contracts for the sale of goods, including sale of goods forming part of a bulk, right of partial rejection, the market overt rule, remedies for delivery of wrong quantity, acceptance of goods and a reasonable opportunity of comparing the bulk with the sample. The relevant provisions in other jurisdictions on these matters prompt the discussion.

11. We would like to point out that the recommendations in this Paper are included to facilitate discussions. We welcome views, comments and suggestions on any issues discussed in this Paper.

Chapter 1

Existing statutory provisions regulating implied terms in contracts for the sale of goods and for the supply of goods, and the need for further legislation

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Overview

1.1 In this chapter, we discuss the need for further legislation on implied terms for supply of goods (other than sale). We first examine the existing statutory provisions regulating the implied terms in contracts for the sale of goods and then discuss the reasons for further legislation on implied terms for supply of goods (other than sale).

1.2 We recommend putting the implied terms for supply of goods (other than sale) into a statutory form – **Recommendation 1.**

Existing statutory provisions regulating implied terms in contracts for the sale of goods and contracts for the supply of goods

1.3 There is no comprehensive code regulating commercial transactions in Hong Kong. The Sale of Goods Ordinance (Cap 26) regulates only sale of goods but not other kinds of the supply of goods. On the other hand, the Control of Exemption Clauses Ordinance (Cap 71) controls exemption clauses in both contracts for the sale of goods and contracts for the supply of goods (other than sale).

The Sale of Goods Ordinance (Cap 26)

1.4 In Hong Kong, contracts for the sale of goods are mainly governed by Cap 26. Cap 26 is based on the Sale of Goods Act 1893 of England & Wales which is a statement of the principles derived from decided cases relating to sales of goods at that time. Cap 26 has been updated from

time to time following changes to the law in England. Cap 26 was last amended in 1994 when the proposals of the Law Reform Commission in its report on *Sale of Goods and Supply of Services* were implemented.[1]

1.5 Under Cap 26, a number of terms are implied in contracts for the sale of goods. These implied terms are classified either as conditions or warranties. Which category a particular term falls into will determine the nature of the remedy available for its breach.[2] The terms implied by Cap 26 in contracts for the sale of goods are undertaking as to title, etc, correspondence with description and sample, and undertakings as to quality and fitness.

1.6 There are many other provisions in Cap 26 which relate to the obligations of sellers and buyers under contracts for the sale of goods, such as provisions as to whether time is of essence and remedies of buyers and sellers on breaches of contractual obligations. These are not the main concern of this Paper and they will only be discussed later where necessary.

The Control of Exemption Clauses Ordinance (Cap 71)

1.7 Cap 71 regulates the extent to which civil liability for breach of contract, for negligence or for other breach of duty can be avoided by means of contract terms. The provisions of Cap 71 follow closely the corresponding provisions of the Unfair Contract Terms Act 1977 of England & Wales.

1.8 Section 11(1) provides that a seller's implied undertaking as to title or quiet possession (under section 14 of Cap 26) cannot be excluded or restricted by reference to any contract term. Section 11(2) provides that as against a person dealing as a consumer, a seller's implied undertakings as to correspondence with description or sample, and as to the quality or fitness of goods for a particular purpose (under sections 15, 16 or 17 of Cap 26) cannot be excluded or restricted by reference to any contract term.

1.9 Section 12 regulates the exclusion or restriction of liability for breaches of obligations arising by implication of law in contracts under which the possession or ownership of goods passes but which are not governed by Cap 26.[3] It is provided that, as against a person dealing as a consumer, the liability in respect of correspondence with description or sample, the quality of goods or their fitness for particular purpose cannot be excluded or restricted by any contract term. Neither can the undertaking as to title or quiet possession be excluded under such a contract term except in so far as the term satisfies the requirement of reasonableness. Hence, the liability for breaches of the terms implied at common law in contracts for the supply of goods (other than sale) cannot, in most cases, be excluded.

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1 See the Sale of Goods (Amendment) Ordinance 1994 (Ord No 85 of 1994).

2 We will examine the difference between conditions and warranties in chapter 7.

3 Examples of such contracts would be contracts for work and materials, contracts of exchange or barter, hire-purchase agreements and contracts of hire.

The need for further legislation on implied terms for supply of goods

1.10 The undertakings implied under Cap 26 only apply to contracts of sale of goods but not other types of contracts for the supply of goods. In Hong Kong, there are no such statutory implied undertakings for contracts for work and materials, contracts of barter, contracts of hire, hire purchase agreements, etc. These contracts are regulated by common law. As we will see in the following chapters, academics support the idea of implying (and courts have been willing to imply), those obligations into contracts for the supply of goods (other than sale). Nonetheless, there is a need to put these implied terms into statutory form for the reasons set out in the following paragraphs.

The pre-requisite for protection under Cap 71

1.11 Contracts for the supply of goods are regulated by common law, but exemption clauses in such contracts are governed by Cap 71. Cap 71 regulates exemption clauses occurring not only in contracts of sale,[4] but also in other types of contracts for the supply of goods. In this sense, some limited protection is given under Cap 71, which restricts a supplier's ability to exclude or restrict his liability for breaching his obligation. Section 12(1) of Cap 71 provides that *"where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods"*, the section has effect in relation to any contract term excluding or restricting liability for breach of obligation arising by implication of law from the nature of the contract. These contracts not governed by the law of sale of goods include contracts of barter, contracts for work and materials, contracts of hire and hire purchase agreements.

1.12 The pre-requisite for such protection is that the court holds that those obligations arise by implication of law. Although courts have been willing to imply those obligations into contracts for the supply of goods (other than sale), for the protection of customers supplied with goods (consumer or not), there is a need to put those supplier's obligations into concrete legislation. Indeed in the 70's, England was in a similar position in this respect to the present situation in Hong Kong. The Law Commission published a working paper on implied terms in contracts for the supply of goods and recommended putting these implied terms into a statute.[5] In reciting the fact that the Law Commission has published a previous report on controlling exemption clauses in contracts for the supply of goods,[6] the Commission stated:

> *"[the] report was concerned with the practice of contracting out obligations, not with what those obligations should be. It now*

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4 Cap 71, s11.

5 Law Commission, *Implied Terms in Contracts for the Supply of Goods,* WP No 71, 1977.

6 Law Commission, Second Report on *Exemption Clauses*, Law Com No 69, 1975.

seems appropriate, at least so far as English law is concerned, that a thorough review of the scope and purpose of such terms should be made".[7]

1.13 It is of no use to a customer, consumer or not, supplied with goods if there is only a statute restricting the supplier's ability to exclude or restrict his liability for breaching his obligations, but the customer is not sure what those obligations are.

For certainty and clarity of the law

1.14 Secondly, there is also a need to put the implied obligations of suppliers into a statute for the sake of certainty and clarity of the law. The following examples can illustrate such a need.

1.15 In the case of contracts of barter, as discussed in the following chapters, there are authorities that the terms implied should be the same as those of sellers in contracts of sale of goods, but there are still uncertainties. Before the enactment of the Sale of Goods Act 1893, it was generally supposed that at common law the obligations of suppliers of goods under contracts of barter were the same as those of sellers of goods.[8] Accordingly, as the Sale of Goods Act 1893 put the principles of law derived from the cases into a statutory form,[9] the Act in its original version should also reflect the legal position on contracts of barter. As Cap 26 was modelled on the Sale of Goods Act 1893, Cap 26 in its original version should also therefore reflect the legal position of contracts of barter in Hong Kong. However, it must be pointed out that there is a view that *"[a]part from statute …the rules of law relating to sales apply in general to contracts of barter or exchange; but the question has been by no means fully worked out."*[10] Therefore, it would seem sensible that the terms to be implied in such contracts should be enumerated and made plain in legislation.

1.16 In the case of contracts for work and materials, as discussed in the following chapters, the obligations of suppliers at common law in respect of the materials supplied were generally regarded as the same as those in contracts of sale.[11] However, in *Gloucestershire County Council v Richardson*,[12] because of the lack of a statutory formula, the House of Lords was divided as to whether a term as to fitness ought to be implied.

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7 Law Commission, *Implied Terms in Contracts for the Supply of Goods,* WP No 71, 1977, at para 9.

8 Lord Blackburn, *Blackburn's Contract of Sale,* 2nd Ed, 1885, at p ix.

9 MacKenzie Chalmers, *The Sale of Goods Act 1893,* 1894, see the Introduction. Sir MacKenzie Chalmers was the draftsman of the Sale of Goods Act 1893.

10 Michael Mark, *Chalmers Sale of Goods,* 18th Ed, 1981, at p 82-83.

11 *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454*, Gloucestershire County Council v Richardson* [1969] 1 AC 454.

12 [1969] 1 AC 480. Lords Pearce and Wilberforce were of the view that the term, which might otherwise have been implied, had been excluded; Lord Upjohn concluded that the term was not implied; Lord Pearson concluded that the term was to be implied.

1.17 In the case of contracts of hire, terms may be implied in a contract of hire that the bailor has the right to hire out the goods and that the hirer is entitled to quiet possession during the period of hire[13] and that the goods are free from undisclosed encumbrances. But, since there is no authority, the law is uncertain. In addition, as discussed in the following chapters, there is uncertainty in the existing law as to the nature and extent of a bailor's obligations regarding quality and fitness for purpose of goods hired out. Although there are some decided cases concerning the implied obligations of a bailor in relation to fitness for purpose of goods, the courts seemed to follow three main lines of thought regarding liability.[14] Furthermore, there are few cases on the implied term as to hire by sample or description, though there is some support for the proposition that there should be an implied term as to hire by sample or description.[15] The position is unsatisfactorily uncertain.

1.18 In the case of hire purchase agreements, as discussed in the following chapters, there is no authority on whether there is an implied term as to quality. Professor R M Goode[16] believes that there is *"no reason why such a term should not be implied"* since the hirer's position has been equated with that of a buyer in respect of other implied terms, namely, title, correspondence with description, quiet enjoyment, etc. Professor Aubrey Diamond has also found it difficult to *"see why there should not be such a term at common law".*[17] Once again, the position is unsatisfactorily uncertain.

1.19 From the above examples, it is clear that most of the implied terms of contracts for the supply of goods are far from being certain and clear. Therefore, there is a need to put the implied obligations of suppliers into a statute.

For consistency of the law

1.20 Thirdly, for the sake of consistency of the law on supply of goods (including sale of goods), the implied terms should be consistent for each type of supply of goods as far as possible. The implied terms for contracts for the sale of goods are in Cap 26 which makes those terms transparent and certain. The terms for other types of supply are far from certain as illustrated by the above examples. Lord Upjohn once stated that if the law treated implied terms differently in contracts of sale from contracts for work and materials, it would be *"most unsatisfactory, illogical, and indeed a severe blow to any idea of a coherent system of common law …"*[18] The

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13 *Lee v Atkinson and Brooks* (1609) Cro Jac 236; 79 ER 204.

14 Approach A (strict liability for ensuring that goods are reasonably fit for their purposes); Approach B (as fit as reasonable skill and care can make); Approach C (negligence-based).

15 See *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584, a hire-purchase case, per Pearson L J at p 595, Upjohn L J at p 597 and Ormerod L J at p 600; *Reardon Smith Line Ltd v YngvarHansen-Tangen* [1976] 1 WLR 989, per Viscount Dilhorne, at p 1000.

16 R M Goode, *Hire Purchase Law and Practice*, 2nd Ed, 1970, at p 241.

17 A Diamond, *Introduction to Hire-Purchase Law*, 2nd Ed, 1971, at p 57.

18 *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454*, Gloucestershire County Council v Richardson* [1969] 1 AC 454.

same can be said of the differences between contracts of sale and other types of supply of goods. In order to ensure the consistency of the implied obligations of suppliers in other types of supply of goods, such obligations should be put into a statute.

Expectations of finding the implied terms in legislation

1.21 Fourthly, other kinds of contracts for the supply of goods, such as contracts of barter, contracts for work and materials and hire-purchase agreements, are commonly used by customers, consumers or not. It is reasonable for persons supplied with goods under such contracts to expect that they would be protected by similar implied terms to those in contracts of sale. By the same token, as the implied terms in contracts of sale are provided in Cap 26, persons acquiring goods through other types of contracts for the supply of goods would also expect to find the implied terms in a statute. The fact that goods are now commonly supplied to consumers through transactions other than sale adds to the desirability of clear legislative provisions.

Experiences of other jurisdictions

1.22 Last but not least, other jurisdictions have already put the implied obligations of suppliers in statutes. A comparison table of statutory implied terms in contracts for the sale and supply of goods is at Annex 1. In Australia, Part V Division 2 of the Trade Practices Act 1974 (Commonwealth – federal level) ("the 1974 Act") contains implied conditions and warranties in contracts for the supply of goods by a corporation to a consumer.[19] Most of the consumer protection provisions of the 1974 Act are expressly limited to the supply of goods by a corporation to a consumer. "Corporation" is defined in section 4(1) and by virtue of section 6, references to a corporation are to be read as including references to a person who is not a corporation.[20] "Consumer" is defined in section 4B.

1.23 In New Zealand, the Consumer Guarantees Act 1993 ("the 1993 Act") implies guarantees in the supply of goods in trade to consumers. The

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19 Some States may have similar statutory implied terms in their State legislation for certain types of contracts, for example, hire purchase. If these implied term provisions in the 1974 Act and the State legislation overlap, a contract may be subject to 2 or more sets of implied terms. In such a case, the consumer has the protection of both sets of statutory implied terms and he may claim relief if there is a breach of one but not the other.

20 Since the provisions of the *Trade Practices Act* are primarily based, for constitutional reasons, on the Commonwealth's (federal) power to make laws with respect to corporations, the conditions and warranties implied by the Act are expressed to apply to contracts for the supply of goods and services by a *corporation*. They will not be implied in contracts for the supply of goods or services by a sole trader, partnership, or other unincorporated body operating within the limits of a particular State. However, by virtue of another provision of the Act (section 6) which extends the operation of the Act as a result of certain other heads of constitutional power, the conditions and warranties will apply to contracts for the supply of goods and services by traders where they are engaged in interstate or overseas trade or commerce, trade and commerce within or involving a Territory, or dealings with the Commonwealth government or any of its instrumentalities.

1993 Act only applies where goods are supplied in trade[21] which is defined in section 2(1),[22] and does not apply to cases where goods are supplied by auction or competitive tender.[23] A "consumer" is a person who acquires the goods of a kind ordinarily acquired for personal, domestic, or household use or consumption.[24] The rights and remedies provided in the 1993 Act are in addition to any other legal rights or remedies, unless those other rights or remedies are expressly or impliedly repealed or modified.[25]

1.24 In England and Wales, terms as to title, correspondence with description or sample, merchantability, and fitness for purposes are implied into contracts of hire purchase by the Supply of Goods (Implied Terms) Act 1973 ("the 1973 Act"). These terms were further extended to contracts of hire and contracts for the transfer of property in goods by Part I of the Supply of Goods and Services Act 1982 ("the 1982 Act"). Both the 1973 Act and the 1982 Act apply to consumer and non-consumer supplies of goods.

1.25 For the above reasons, we are of the view that the implied obligations of suppliers in contracts for the supply of goods (other than sale) should be put into a statute and we so recommend.

Recommendation 1

We recommend that the implied obligations of suppliers in contracts for the supply of goods should be put into a statute, the Recommended Legislation.

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21 Section 41(1). According to section 41(2), there is no right of redress against a charitable organisation where goods are supplied by the charitable organisation for the principal purpose of benefiting the person to whom the supply is made.

22 "Trade" means any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services.

23 Section 41(3).

24 Section 2(1). A person is not a "consumer" if he acquires the goods, or gives the impression that he acquires the goods, for the purpose of resupplying them in trade; or consuming them in the course of production or manufacture; or repairing or treating in trade other goods or fixtures on land.

25 Section 4(1). No provision of the 1993 Act is to be construed as repealing, invalidating, or modifying the provisions of any other Act, except where there is an express provision, or clear intention by necessary implication, to do so: section 4(2).

Chapter 2

What are contracts for the supply of goods ?

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Overview

2.1 In this chapter, we explain the expression "contracts for the supply of goods". The first part examines "contracts for supply" while the expression "goods" will be discussed in the following part. In particular, we examine three types of contracts for supply, namely, contracts for transfer of property in goods, contracts of hire and contracts of hire purchase. For each of these three types of contracts, we discuss the elements involved, types of transactions not covered, and the legislative treatment of each type in other jurisdictions. We then propose definitions for each type of contract in **Recommendations 2, 3 and 4** respectively.

2.2 We then turn to the element "goods" and examine the appropriateness of the definitions in the Sale of Goods Ordinance (Cap 26), and the legislation of other jurisdictions. We suggest that the definition of "goods" in Cap 26 should be followed in **Recommendation 5**.

2.3 As computers have now become so commonly used and influential in everyday life, we address the issue whether computer software is "goods". We examine relevant cases in various jurisdictions and conclude that it is preferable to await a more comprehensive study of this topic and make no recommendation accordingly. In this respect, our concern is limited to the implied terms for contracts for the supply of computer software only. Issues such as licensing and copyright are beyond the terms of reference of this Paper and may have to be separately dealt with.

Introduction

Contract of sale

2.4 A contract of sale is defined in section 3(1) of Cap 26 as:

> *"... a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price. There may be a contract of sale between one part owner and another."*

2.5 As a contract for the sale of goods is defined to require both the transfer of title and the provision of money consideration, where either element is missing, the contract is not a contract of sale but may be called a "contract for the supply of goods". A contract for the supply of goods may thus be generally understood as a contract whereby a supplier transfers either possession or ownership of goods to another person for a consideration which may or may not include money.

Other types of supply of goods

2.6 Where goods are supplied under a contract but the consideration for the contract is not wholly found in the price of the goods, the contract is not a sale. An example of this type of contract is a contract of barter. As discussed later, at common law, a contract of sale of goods is distinguished from a contract for work and materials.

2.7 Contracts which involve money consideration but do not involve the transfer of title in goods are not contracts for the sale of goods. Examples are contracts for the hire of goods and contracts of hire purchase. Under a contract for the hire of goods or a contract of hire purchase, title to goods does not pass. Only possession of the goods passes.

2.8 Contracts of barter, contracts for work and materials, contracts of hire and contracts of hire purchase are therefore outside the definition of contracts of sale. Cap 26 does not govern these contracts. In Hong Kong, they are governed by the common law so far as the implied obligations of the suppliers under these contracts are concerned.[1]

2.9 Where goods are transferred for no consideration, the transfer is a gift and not contractual in nature.

2.10 In referring to contracts for the supply of goods, we exclude non-contractual transactions (such as gifts) and contracts concerning things other than movable property (such as land and choses in action).

Three types of contracts for the supply of goods

2.11 In this Paper, we will consider three types of contracts for the supply of goods:

1. contracts for the transfer of property in goods – under which the supplier transfers property in goods to the person supplied in a manner which, for some reason, does not fall within Cap 26.

[1] The service element under a contract for work and materials is governed by the Supply of Services (Implied Terms) Ordinance (Cap 457).

2. contracts of hire – under which the supplier transfers possession of the goods to the person supplied for the latter's use and enjoyment without transferring the property.

3. contracts of hire purchase – under which goods are bailed to the hirer in consideration for the payment by the hirer of hire-rent coupled with an option to purchase the goods.

Contracts for the transfer of property in goods

Elements of contracts for the transfer of property in goods

Elements involved

2.12 The term "contracts for the transfer of property in goods" by itself means any contract under which a person transfers or agrees to transfer to another the property in goods. This covers various types of contracts, for example, sale of goods, work and materials, barter, hire purchase, etc.

2.13 Contracts for the transfer of property in goods for the present discussion should cover contracts under which property in goods is transferred, whether or not services are also provided (for example, contract for work and materials). Since property in goods is transferred, there should be protection by the same statutory implied terms as in a sale of goods contract, even though services are also supplied. In addition, while consideration other than by the presumption by deed is a prerequisite, the nature of the consideration should not matter for a contract to be a contract for the transfer of property in goods. An example of such a contract is one to exchange goods for goods, ie barter.

Transactions not covered

2.14 As Cap 26 already regulates contracts for the sale of goods, the present discussion about contracts for the transfer of property in goods does not cover sale of goods. As hire purchase involves hire, with the possibility of later sale, it will be discussed under a separate heading.

2.15 In referring to contracts for the supply of goods, we are excluding non-contractual transactions such as gifts. A transaction which is made by a deed (and for which there is no consideration apart from that presumed by a deed) should also be excluded since it is more akin to a gift than to supply of goods, although strictly contractual.

2.16 According to section 62(4) of Cap 26, contracts operating by way of mortgage, pledge, charge or other security are specifically excluded from the protection of Cap 26. For example, under a legal mortgage of goods, the property in goods is transferred to secure a debt, but the mortgagor often retains possession of the goods subject to the mortgagee's power to take possession of the goods if the mortgagor defaults on repayment. The

mortgagee is not protected under Cap 26. By the same token, contracts for the transfer of property in goods for the present discussion should exclude contracts operating by way of mortgage, pledge, charge or other security.

Two major types of contracts for the transfer of property in goods

2.17 There are two major types of contracts for the transfer of property in goods:

- barter, and
- contracts for work and materials (a table containing the complaint statistics is at Annex 2).

Barter

2.18 Under section 3 of Cap 26, the consideration for the transfer of property in contracts of sale must be money, the price. Barter is usually understood to mean the trading of goods for other goods without fixing the price. Barter can also refer to the supply of goods in return for services, or for both goods and services. Barter arises when goods (or services or other equivalent[2]) are specifically traded for goods of another. The parties themselves can agree that the transaction (what might have been barter) takes the form of reciprocal sales, with a mutual set-off of prices and a cash adjustment (if necessary). For instance, goods "for a price to be satisfied by" other goods would be regarded as reciprocal sales, while goods passed "in consideration of" other goods would be regarded as barter.[3]

2.19 Goods are sometimes supplied under a transaction loosely known as "trading in" or "part exchange". This mode of supply of goods is well established and quite common in the motor trade. Goods are supplied in return for some other, usually less valuable, goods, together with the payment of a sum of money. A price is usually fixed for the more valuable goods. A value is then put on the goods to be traded-in. The sum of money represents the difference in value of the exchanged goods. The nature of "trading in" depends on how the facts of each case are interpreted.[4]

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2 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 1-037.

3 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 1-037. In *Aldridge v Johnson* (1875) 7 EB 885, the parties agreed 32 bullocks should be transferred by Aldridge to Knights and 100 quarters of barley should be transferred by Knights to Aldridge, the difference to be paid in cash. It was held that there were mutual sales. Professor L Sealy is of the view that had the deal been that 100 quarters of barley be traded for 32 bullocks, or for 32 bullocks plus a sum of money, without any valuation of consideration on either side, it could only be regarded as barter (*Benjamin's Sale of Goods,* 5th Ed, 1997, at para 1-037).

4 A deal can be regarded as reciprocal sale with a set-off of prices, or as one contract of sale, of the principal goods, together with a subsidiary arrangement that if the buyer delivers to the seller the other goods, an agreed allowance will be made. *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 1-039.

Contracts for work and materials

2.20 At common law, a contract of sale of goods is distinguished from a contract for work and materials. The general rule deducible from the cases in which the distinctions were drawn seems to be that if the main object of the contract is the transfer from A to B, for a price, of the property in a thing in which B has no previous property, then the contract is a contract of sale. But if the real substance of the contract is the performance of work by A for B, it is a contract for work and materials even though the performance of the work necessitates the use of certain materials and the property in those materials passes from A to B under the contract.[5] In the latter case, the passing of goods is only ancillary to the supply of the services contracted for.

2.21 As a result of the distinction, certain contracts of supply[6] have been held to be contracts of sale; whereas other contracts of supply[7] have been held to be contracts for work and materials. Other examples of contracts for work and materials include contracts to repair a car,[8] apply a hair-dye[9] and roof a house.[10]

Other types of contracts for the transfer of property in goods

2.22 Some retailers, such as supermarkets, give stamps, coupons or vouchers upon purchase of goods by customers to promote sales or particular products. Sometimes goods are offered in return for the stamps or coupons without the payment of money, and on other occasions goods are offered for a reduced price on surrender of the stamps or coupons which the customer is allowed to trade in as part of the consideration.[11] Goods may also be supplied as a bonus to which a customer becomes entitled on purchasing a certain quantity of the products which are being promoted and in some circumstances the transaction merely involves a free gift.[12]

2.23 Sometimes there is a contract for the supply of goods in return for the coupons or labels with or without payment in addition; the contract is either a sale or barter but the distinction is not always clear. For example, in *Chappell & Co Ltd v Nestle Co Ltd*,[13] the defendants offered a gramophone record to members of the public for a sum of money together with the tender of three of their chocolate wrappers. The nature of the transaction was not in

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5 Michael Mark, *Chalmers Sale of Goods*, 18th Ed, 1981, at p 80-81.

6 For example, supplying a meal in a restaurant, *Lockett v Charles* [1938] 4 All ER 170; making and fitting false teeth, *Lee v Griffin* [1861] 30 LJ QB 252 cf *Samuels v Davis* [1943] KB 526; making mink jackets from skins selected by the customer, *Marcel (Furriers) Ltd v Tapper* [1953] 1 All ER 15; [1953] 1 WLR 49; providing and laying fitted carpets, *Philip Head & Sons, Ltd v Showfronts, Ltd* [1970] 1 Lloyd's Rep 140.

7 For example, printing 500 copies of a treatise, where the printer supplies the paper, *Clay v Yates* [1856] 1 H & N 73; painting a portrait, *Robinson v Graves* [1935] 1 KB 579.

8 *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46.

9 *Watson v Buckley, Osborne, Garrett & Co Ltd* [1940] 1 All ER 174.

10 *Young & Marten Ltd v McManus Childs Ltd* [1969] AC 454.

11 In England, the supply of goods on redemption of trading stamps is governed by the Trading Stamps Act 1964.

12 cf *Esso Petroleum Co Ltd v Commissioners of Customs and Excise* [1976] 1 WLR 1.

13 [1960] AC 87.

issue in the case but one of the law lords thought that the transaction was not a sale.[14]

2.24 The case of *Esso Petroleum Co Ltd v Commissioners of Customs and Excise*[15] illustrates the difficulties of distinguishing whether a transaction is a gift, a sale or barter. Esso had a petrol sales promotion scheme. Under the scheme, coins were distributed to petrol stations. The petrol station proprietor offered to give away a coin for every four gallons of Esso petrol bought. The issue was whether the coins were being "sold" and were accordingly chargeable to purchase tax. The House of Lords was divided[16] as to whether the scheme was a gift, collateral contract or sale.

2.25 The importance of distinguishing a gift from a sale or barter is that a person who receives a gift is not protected by the statutory implied terms in the sale of goods legislation. As discussed in the following chapters, the position of barter is uncertain, although terms implied in contracts of sale may be followed.

2.26 Promotion tactics such as those referred to in the previous paragraphs are common in retail trade in Hong Kong. In these transactions there is a transfer of property in goods. It is the substance of the transaction which determines its nature, ie whether it is a gift, a sale, a collateral contract or barter. In this Paper, these promotion tactics are included as contracts for the transfer of property in goods if they are not regarded as sales or gifts.

Australia

2.27 In Australia, the Trade Practices Act 1974 (the 1974 Act), which stipulates implied terms for contracts for the supply of goods, does not define the scope of contracts for the transfer of property in goods. Instead, it provides in section 4 that:

> *"supply …includes …in relation to goods - supply (including re-supply) by way of sale, exchange, lease, hire or hire purchase"*

2.28 Even though it is an inclusive definition, it is not clear whether some types of contract for the transfer of property in goods (for example, the promotion tactics used in retail trade) are covered by the 1974 Act. Contracts for work and materials are covered by section 74 which provides separately

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14 In a Canadian case on similar facts, *Buckley v Lever Bros Ltd* [1953] 4 DLR 16, the Court treated the transaction as one of sale. See also the diverging views of the law lords in the *Esso* case below.

15 [1976] 1 WLR 1.

16 Lord Fraser thought there was a sale. Viscount Dilhorne and Lord Russell both thought that the Court of Appeal were right in holding that the coins were being distributed as gifts. Lord Simon and Lord Wilberforce, on the other hand, ruled that the supply of the coins to the motorists was contractual but without there being a sale; the consideration for the transfer of the coin or coins was not a money payment but the undertaking by the motorist to enter into a main contract to purchase the appropriate quantity of Esso petrol. Professor Atiyah has mentioned that if there were a collateral contract, "*it would presumably be a contract for the transfer of goods within*" the 1982 Act. P S Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 9.

some implied warranties for this type of contract. As contracts for work and materials and other types of contract for the transfer of property in goods are common in Hong Kong, it would be sensible for the Recommended Legislation to cover them expressly.

New Zealand

2.29 In New Zealand, the Consumer Guarantees Act 1993 (the 1993 Act), which regulates implied terms for contracts for the supply of goods, does not define the scope of contracts for the transfer of property in goods. Instead, it provides in section 2 that:

> *"supply …in relation to goods, means supply (or resupply) by way of gift, sale, exchange, lease, hire or hire purchase"*

2.30 Unlike its Australian counterpart, this is an exhaustive definition and includes supply by way of gift. Section 15 of the 1993 Act provides that the guarantees in the Act apply whether or not the goods are supplied in connection with a service, and contracts for work and materials are therefore also covered.

England and Wales

2.31 In the Supply of Goods and Services Act 1982 (the 1982 Act), the scope of contracts for the transfer of property in goods is defined in section 1 as follows:

> *"(1) In this Act in its application to England and Wales and Northern Ireland a 'contract for the transfer of goods' means a contract under which one person transfers or agrees to transfer to another the property in goods, other than an excepted contract.*
>
> *(2) For the purposes of this section an excepted contract means any of the following –*
>
> *(a) a contract of sale of goods;*
>
> *(b) a hire-purchase agreement;*
>
> *(c) a contract under which the property in goods is (or is to be) transferred in exchange for trading stamps on their redemption;*
>
> *(d) a transfer or agreement to transfer which is made by deed and for which there is no consideration other than the presumed consideration imported by the deed;*

(e) a contract intended to operate by way of mortgage, pledge, charge or other security.

(3) For the purposes of this Act in its application to England and Wales and Northern Ireland a contract is a contract for the transfer of goods whether or not services are also provided or to be provided under the contract, and (subject to subsection (2) above) whatever is the nature of the consideration for the transfer or agreement to transfer."

2.32 The definition in section 1 is wide. Professor N E Palmer makes the following comments about the scope of the definition:[17]

> *"Sections 1 to 5 affect many different transactions, ranging from contracts of work and materials and exchange to the numerous innominate contracts whereunder a party transfers (or agrees to transfer) his property in goods to another. An obvious example of this residual category is the supply of 'free gifts' or 'bargain offers' which are obtainable by some prescribed act on the part of the prospective transferee, such as the despatch of a coupon or label or the entry into an associated contract with the supplier or a trading acquaintance."*

Conclusion

2.33 The expression "contracts for the transfer of goods" is widely defined in the 1982 Act and means a contract under which there is a transfer of property in goods. This includes barter and contracts for work and materials. Professor Palmer has pointed out that the definition covers any contract "*whereunder a party transfers (or agrees to transfer) his property in goods to another*", other than an excepted contract.[18] This was deliberate, according to the England & Wales Law Commission Report[19] which was the catalyst for the 1982 Act, in order to cover types of contracts other than barter and contracts for work and materials under which property in goods is transferred.[20] Section 1 of the 1982 Act is in line with our thinking as to what the scope of contracts for the transfer of property in goods in Hong Kong should be. Professor Palmer has commented that "*sections 1 to 5 constitute a valuable reform …and the clarity which they afford to orthodox supply transactions is unquestionably beneficial.*"[21]

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17 N E Palmer, "The Supply of Goods and Services Act 1982", (1983) 46 MLR 619, at p 620.

18 N E Palmer, "The Supply of Goods and Services Act 1982", (1983) 46 MLR 619, at p 620.

19 Law Com No 95, at para 28.

20 These include the promotional tactics used by the retail trade, for example, goods supplied for labels, wrappers, coupons or vouchers with or without money, so long as they are not regarded as gift or sale.

21 N E Palmer, "The Supply of Goods and Services Act 1982", (1983) 46 MLR 619, at p 623.

2.34 Although contracts of barter and for work and materials are the two major types of contracts for the transfer of property in goods, our concern is about contracts for the transfer of property in goods in general. Apart from contracts of barter and for work and materials, other types of transactions under which property in goods is transferred (for example, promotional tactics used by the retail trade: barter or collateral contracts) should also be covered under this category.

Recommendation 2

We recommend that:

(a) a contract for the transfer of property in goods should be treated in the Recommended Legislation as a type of contract for the supply of goods;

(b) it should be defined to mean a contract under which a person transfers or agrees to transfer to another the property in goods;

(c) it may involve services as well and the type of consideration involved should be irrelevant (except where that is merely presumed by a deed); and

(d) the definition should exclude:

- **(i) contracts of sale;**
- **(ii) hire purchase agreements;**[22]
- **(iii) contracts operating by way of mortgage, pledge, charge or other security; and**
- **(iv) transfers or agreements to transfer by deed and for which there is no other consideration apart from that presumed by the deed.**

Contracts of hire of goods

2.35 The law concerning contracts of hire is found partly in the law of bailment and partly in the general law of contract. As to the law of bailment, Holt C J identified six categories of bailment in *Coggs v Bernard*:[23] deposit, gratuitous loan, hire, pledge, delivery for carriage (or management or repair) for reward and delivery for carriage (or management or repair) without recompense. All the six categories involve the delivery of goods by one person, the bailor, to the other, the bailee, without transferring title. However, only hire of goods involves supply of goods by one person for the use and enjoyment of another. Therefore, questions of merchantability of the goods

[22] We will discuss hire purchase agreements as a separate category later in this chapter.

[23] (1703) 2 Ld Raym 909; 92 ER 107.

and their fitness for use being implied into the contract should only arise under contracts of hire. A table containing the complaint statistics is at Annex 2.

Elements of contracts for hire of goods

2.36 Under a contract of hire of goods, the property in the goods does not pass under the contract to the bailee of the goods (that is, the hirer). The property remains in the owner of the goods and he is the "lessor". Only the right to possession, use and enjoyment of the goods pass when the goods are transferred. This type of contract may be described as a "lease", "rental agreement", "contract of hire" or the like. The present discussion focuses only on contracts of hire but covers all such contracts by whatever description, under which one party bails or agrees to bail goods to another party by way of hire.

Consideration

2.37 Money is the usual consideration for this type of contract. A hirer can hire goods for a specific occasion in return for a single payment or he can hire over longer periods for the payment of a rental payable daily, weekly, monthly or yearly. Examples of the former type are the hiring of video films, cars and clothing such as dinner jackets, and examples of the latter type are the hiring of televisions, photocopying machines, plant and machinery.

2.38 It is also possible to hire for a consideration other than the payment of money. In *Mowbray v Merryweather*[24] the plaintiffs were stevedores and they contracted to unload the defendant's vessel on the condition that the defendant would lend them all necessary cranes, chains and other equipment. The stevedores were the "hirers" of the cranes, chains and equipment though they paid nothing for the use of them; and the ship-owner was the "supplier".

Types of contracts not included

2.39 There are contracts under which services are rendered involving the use of goods (such as a ship or a piece of machinery) but the goods remain under the control of the person rendering the services (the ship-owner or the owner of the machinery). As the possession of the goods in question is not transferred, the contract is not treated as a contract of hire for the present purposes. Where possession is transferred, it is treated as a contract of hire for the purpose of the present discussion whether or not services are rendered as well. In daily life, examples of contracts of hire with services provided are the hire of telephones with the facility of making calls and the hire of photocopying machines with servicing provided.

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[24] [1895] 2 QB 640.

2.40 Contracts of hire purchase are not merely contracts of hire since under a contract of hire purchase, the hirer obtains an option to acquire the title of the goods later, not just the possession, use and enjoyment of the goods. We will discuss hire purchase agreements as a separate category later in this Paper.

Australia and New Zealand

2.41 Contracts of hire are not defined in the 1974 Act in Australia and the 1993 Act in New Zealand, even though contracts of hire are covered under the definition of "supply" in both Acts.

England and Wales

2.42 In the 1982 Act, the scope of contracts for hire of goods is defined in section 6:

> *"(1) In this Act in its application to England and Wales and Northern Ireland a 'contract for the hire of goods' means a contract under which one person bails or agrees to bail goods to another by way of hire, other than an excepted contract.*
>
> *(2) For the purposes of this section an excepted contract means any of the following –*
>
> *(a) a hire-purchase agreement;*
>
> *(b) a contract under which goods are (or are to be) bailed in exchange for trading stamps on their redemption.*
>
> *(3) For the purposes of this Act in its application to England and Wales and Northern Ireland a contract is a contract for the hire of goods whether or not services are also provided or to be provided under the contract, and (subject to subsection (2) above) whatever is the nature of the consideration for the bailment or agreement to bail by way of hire."*

2.43 The definition in section 6 is wide. Professor N E Palmer makes the following comments about the definition:[25]

> *"A broad definition of contracts of hire is given by section 6 … The section further provides that the nature of the hirer's consideration is immaterial to the character of the contract as*

[25] N E Palmer, "The Supply of Goods and Services Act 1982", (1983) 46 MLR 619, at p 625.

one of hire, . … The result could again be the inclusion ... of a much wider circle of transactions …. The list includes the bailment of furniture or appliances under a lease of furnished premises …"

Conclusion

2.44 We think it would be inappropriate to limit in a statute the consideration for a contract of hire to money, since at common law the nature of the consideration is also immaterial. Section 6 of the 1982 Act reflects our view as to on what the scope of contracts of hire in Hong Kong should be.[26]

Recommendation 3

We recommend that:

(a) a contract of hire should be treated in the Recommended Legislation as a type of contract for the supply of goods;

(b) it should be defined to mean a contract under which a person bails or agrees to bail goods to another by way of hire; and

(c) the definition should include contracts involving services, and the type of consideration involved should be irrelevant.

Hire purchase agreements

2.45 In our modern society, as sellers are keen to do business, buyers are often encouraged to acquire goods on credit rather than for cash. But one of the risks of a seller who supplies goods on credit is the failure by the buyer to pay. To overcome this problem, different sorts of financing and security transactions have been devised. A type of transaction commonly used in the supply of goods is a hire purchase agreement. It is commonly used in respect of not only consumer goods, such as, electrical appliances, motor vehicles, etc, but also commercial goods, such as, plant and machinery.

2.46 In reality, sellers of goods are often retailers and they are not in the business of providing credit to customers. Retailers will sell the goods selected by customers to finance companies which become owners of the goods. The finance companies then enter into hire purchase agreements with

[26] Section 6(2)(b) of the 1982 Act about trading stamp is not relevant to our discussion since there is no statute equivalent to the Trading Stamps Act 1964 in Hong Kong.

the customers to let the goods to them. Contracts between retailers and finance companies are contracts of sale. Contracts between finance companies and hirers are hire purchase agreements. Though finance companies are owners of the goods, their functions are actually to provide finance. This type of arrangement is commonly used with motor vehicles. A table containing the complaint statistics is at Annex 2.

Elements of hire purchase agreements

Bailment with an option to purchase

2.47 A hire purchase agreement is a contract under which goods are bailed to the hirer in consideration for the hire-rent paid by the hirer. It differs from a contract of hire in that the hirer under a hire purchase agreement is also given an option to purchase the goods within the hire period.[27] Professor R M Goode stated: *"[a] hire purchase agreement as known to common law may be defined as a contract for the delivery of goods under which the hirer is granted an option to purchase the goods".*[28] It is expected that the hirer will exercise the option, and the rate charged for the hire will be calculated on the basis of the cash price of the goods, plus interest, and not on the market rate for hiring the goods. The House of Lords held in *Helby v Matthews*[29] that a hirer under a hire purchase agreement had no proprietary interest in the goods hired until he had exercised his option to purchase and, as the hirer was not a buyer in possession, a sale by the hirer before all the instalments had been paid did not operate to transfer ownership to the sub-buyer.

Two classes of hire purchase agreements

2.48 The exercise of the option to purchase is important in the context of hire purchase. Hire purchase agreements fall into the following two classes:

> *"(a) agreements whereby the hirer takes the goods on hire for a stated rent and is given an option to purchase the goods at the end of the hiring on payment of an additional sum ('the option fee') which in practice is usually nominal; and*
>
> *(b) agreements under which the price of the option to purchase is paid at the outset, or included in the hire-rent payable, so that the property in the goods passes automatically to the hirer on completion of the instalments*

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27 A "hire purchase agreement" was defined under s1 of the Hire-Purchase Act 1965 of UK as "*an agreement for the bailment of goods under which the bailee may buy the goods, or under which the property in the goods will or may pass to the bailee*".

28 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 32.

29 [1895] AC 471.

stipulated, without the active exercise of any option to purchase."[30]

2.49 An agreement falling under the first category, and under which the option fee is not purely nominal, does not require the inclusion of a power enabling the hirer to determine the hiring in order to prevent the agreement in question from being construed as a contract of sale. The property in the goods does not pass even at the end of the hire period unless the hirer exercises the option by paying the option fee. An agreement of this type is a true hire purchase agreement even though the hirer has no power to terminate the hiring before the expiration of the period of hire.[31] But if the option fee is only nominal, the position has not been clear until recently.[32] It was held in *Close Asset Finance Ltd v Care Graphics Machinery Ltd*[33] that such an agreement was not an agreement to buy since "*the hirers had not committed themselves to exercising the option or committed themselves to take title to the [goods]*".

2.50 An agreement of the second category might be classified as a contract of sale or as an agreement to sell unless the agreement contains a clause enabling the hirer to determine the hiring before the final instalment of hire becomes payable, for otherwise, except by breaking the contract, the hirer cannot avoid ultimately acquiring the title to the goods.[34]

It is the nature of the transaction that matters

2.51 Whatever name an agreement is called, it is the nature of the transaction that determines the actual nature of the agreement. In *Sun Hung Kai Credits Ltd v Szeto Yuk Mei*,[35] in deciding whether the guarantee was valid, the court held that the purported hire purchase agreement gave the hirer no right to terminate the agreement and no option to purchase the bus. The agreement was therefore a conditional sale.

2.52 Both hire purchase and conditional sale may require payment of the contract price by instalments. In the case of a conditional sale, a buyer does not have a right to terminate the agreement or an option to buy. This distinguishes it from a hire purchase agreement. A conditional sale agreement is a contract of sale.[36]

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30 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 33.

31 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 33.

32 Professor Goode has said that in England this has never been decided, but in the United States and Australia, the courts will treat the agreement as a conditional sale agreement. R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 47.

33 Times L R 21 March 2000.

34 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 34.

35 [1985] 1 HKC 345. Sun Hung Kai supplied a public light bus to a 'hirer' under an agreement which was expressed to be a hire purchase agreement. The hirer paid the first two instalments but then terminated the agreement, and Sun Hung Kai sued the hirer and the guarantor.

36 "*A contract of sale may be absolute or conditional*". Section 3(2) of Cap 26.

Australia and New Zealand

2.53 The expression "hire purchase agreement" is not defined in the 1974 Act of Australia and the 1993 Act of New Zealand even though hire purchase agreements are covered under the definitions of "supply" in both Acts.

2.54 In Australia, only Queensland, Tasmania, Victoria and Western Australia retain their Hire-Purchase Acts which contain definitions of "hire purchase agreement". The definitions in the Hire-Purchase Acts of Queensland, Tasmania and Victoria[37] are similar. They define "hire purchase agreement" to include a letting of goods with an option to purchase and an agreement for the purchase of goods by instalments. But it does not include (a) any agreement whereby the property in goods passes at the time of the agreement, or (b) any agreement under which the hirer or purchaser engages in the trade or business of selling goods of the same nature or description, or (c) any contract regulated by the relevant Credit Acts or Consumer Credit Code.[38] This is an expanded meaning of "hire purchase agreement".

2.55 In New Zealand, "hire purchase agreement" is defined in the Hire Purchase Act 1971 (section 2) to mean an agreement whereby goods are let or hired with an option to purchase, or an agreement for the purchase of goods by instalment payments under which possession is passed before the total amount payable has been paid. But it does not include (a) any agreement made other than by retail, or (b) subject to the deeming provisions,[39] under which the property in the goods passes absolutely at the time of the agreement or upon or at any time before delivery. The meaning of "hire purchase agreement" in the Hire-Purchase Act 1971 was also expanded beyond the common law meaning.

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37 The definition in section 2 of the Hire-Purchase Act 1959 Western Australia is much wider and includes –

"(a) a letting of goods with an option to purchase;

(b) any agreement under which there is a bailment of goods and either the bailee may buy the goods or the property in the goods will or may pass to the bailee;

(c) any agreement for the purchase of goods by instalments (whether the agreement describes the instalments as rent or hire or otherwise) if the vendor or any person other than the hirer or his guarantor retains any interest in the goods or is or may become entitled to repossess the goods or to cause the hirer to lose his property in the goods; and

(d) any agreement whereby the property in the goods comprised therein passes at the time of the agreement or upon or at any time before delivery of the goods, if the vendor or any person other than the hirer or his guarantor retains any interest in the goods or is or may become entitled to repossess the goods or to cause the hirer to lose his property in the goods."

38 (QLD) Hire-Purchase Act 1959 s2; (TAS) Hire-Purchase Act 1959 s4; (VIC) Hire-Purchase Act 1959 s2.

39 Section 2(5) and (6). An agreement is deemed to be a hire purchase agreement where it is a condition of the agreement to sell goods at retail that the buyer grants security over the goods to the seller for the purchase price and the property passes subject to that condition. In addition, where any person lends money upon the security of any goods that have been bought or are to be bought at retail, the sale and the loan are deemed to be a hire purchase agreement if (a) the purchase price is to be paid out of the proceeds of the loan; and (b) the loan is either made by the seller, or arranged by the seller and made by a person who is engaged in the business of lending money or who habitually lends money in the course of his business.

England and Wales

2.56 Section 15 of the Supply of Goods (Implied Terms) Act 1973 (the 1973 Act), which sets out the implied terms for hire purchase agreements, defines "hire purchase agreement" as:

> *"an agreement, other than a conditional sale agreement, under which –*
>
> *(a) goods are bailed or (in Scotland) hired in return for periodical payments by the person to whom they are bailed or hired, and*
>
> *(b) the property in the goods will pass to that person if the terms of the agreement are complied with and one or more of the following occurs –*
>
> *(i) the exercise of an option to purchase by that person,*
>
> *(ii) the doing of any other specified act by any party to the agreement,*
>
> *(iii) the happening of any other specified event."*

2.57 The definition of "hire purchase agreement" in section 15 was added to the 1973 Act as a consequential amendment to the Consumer Credit Act 1974 which contained an identical definition in section 189(1). An academic has called this definition "an expanded and more precise definition".[40]

2.58 Professor R M Goode has commented[41] that this definition was wider in scope and covered agreements which had not been regarded as hire purchase agreements before. An agreement is a hire purchase agreement even if the event causing property to pass is not a voluntary act of the owner or hirer but the happening of some other specified event.

2.59 In *R v R W Proffitt Ltd,*[42] a rental agreement provided that at the end of the hiring the hirer was given the option of purchasing the goods subject to the enactment of the necessary legislation. Jones J held in this case that the rental agreement did not fall within the definition of hire purchase agreement in the Hire-Purchase Act 1938. The "enactment of the necessary legislation" could be regarded[43] as "the happening of any other specified event" and the agreement between the parties would then be a hire purchase agreement under this new definition.

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40 John Mickleburgh, *Consumer Protection*, 1979, at p 23.

41 R M Goode, *Introduction to Consumer Credit Act 1974*, 1974, at para 3.40.

42 [1954] 2 QB 35.

43 John Mickleburgh, *Consumer Protection*, 1979, at p 23 and R M Goode, *Introduction to Consumer Credit Act 1974*, 1974, at para 3.40.

Conclusion

Wider definition is preferred

2.60 The court has not decided on the real nature of the rental agreement in *R v R W Proffitt Ltd*. From the nature of the rental agreement in that case, the court would probably classify it as a conditional sale agreement, but not a rental agreement (even though it was named so) since the property would pass subject to some conditions. That agreement would then be a contract of sale within the Sale of Goods Act 1979 (the "1979 Act"). The ramification is that the "buyer in possession" exception to the *nemo dat quod non habet* rule[44] (embodied in section 25(1) of the 1979 Act) would be applicable. The effect of section 25 is that a buyer under that agreement who is in possession of the goods may confer ownership on a bona fide sub-buyer, even though the buyer himself has not yet acquired the property in the goods. That is unfair to the seller under the first sale agreement, ie the owner of the goods.

2.61 The expanded definition of hire purchase agreement introduced by section 15 of the 1973 Act (as added by the Consumer Credit Act 1974) will cover agreements like that in *R v R W Proffitt Ltd*. Such agreements may then be treated as hire purchase agreements and not conditional sales. The buyer in possession exception to the *nemo dat* rule would then not apply and this should prevent unfairness to an innocent bailor, ie the owner of the goods.

2.62 In Hong Kong, there is an equivalent buyer in possession exception to the *nemo dat* rule embodied in section 27(2) of Cap 26. To minimise unfairness to a bailor, we believe that an expanded definition of hire purchase agreement would also be appropriate for Hong Kong.

Wider definition but yet still confined to bailment is preferred

2.63 In Professor R M Goode's view, "*[t]he given elements in any definition [of hire purchase] are:*

> *(1) that goods are being hired*
>
> *(2) that the property will pass to the hirer*
>
> *but*
>
> *(3) the hirer has a right not to go all the way, either because he has to exercise a positive option to buy or because he can terminate the hire agreement before incurring an obligation to pay the full price."*[45]

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[44] This Latin maxim means that one cannot give what he does not have: a seller cannot give the buyer any better title than he himself has.

[45] In a fax dated 18 May 1999 from Professor Goode to the Secretary of the Sub-committee.

2.64 As to the first element mentioned above by Professor Goode, hiring of goods, the expanded definitions of hire purchase agreement in both Australia (Queensland, Tasmania and Victoria) and New Zealand cover purchase of goods by instalment payments, but not just hire of goods. The definition in the Hire-Purchase Act 1959 of Western Australia is even wider. As mentioned above, the deeming provisions in section 2(5) and (6) in the Hire-Purchase Act 1971 of New Zealand also cover some types of contracts of sale. Such expanded definitions with scope wider than bailment of goods may be too drastic for Hong Kong.

2.65 The definition in the 1973 Act of England and Wales is expanded but yet is still confined to bailment. It is not limited to *"the case where the bailee has an option to purchase - any other contingent agreement, not being a conditional sale agreement, whereby the property in goods may pass to the bailee"*[46] would be within the UK definition. Professor Goode is of the view that the definition in the 1973 Act was drafted to be as comprehensive as possible.[47] Professor Paul Dobson stated[48] that the inclusion of subparagraph (iii) in section 15 of the Act was *"an anti-avoidance provision in case anything which ought to be caught by the definition is not caught by (i) or (ii)"*. After discussing with Mr Francis Bennion, the draftsman of the Consumer Credit Act 1974, Professor Dobson further stated:[49]

> *"the definition was drafted this way in order to capture a concept. That concept is one where goods are hired but where there is an additional element in the agreement, namely that property (not will, but) might pass to the hirer. That additional element is then one where property might pass to the hirer and where that passing of property depends upon a contingency. That contingency will often, of course, be the exercise by the hirer of an option. It might, however, be anything and subparagraph (iii) makes this clear . … It would also be accurate to describe such a hiring agreement as an agreement of hire where property in the hired goods might, depending on a contingency, pass to the hirer - ie they are agreements to hire with the chance that they will turn into methods of conveying property in the goods".*

Hirer has the right but not the obligation to buy the goods

2.66 The second element, passing of property to the hirer, is straightforward and requires little elaboration. The third element, a hirer's right but not obligation to buy the goods, can be illustrated by the following cases.

2.67 In *Lee v Butler*,[50] the hirer agreed to hire some furniture by paying rental in two instalments. On paying the second instalment, the

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46 Francis Bennion, *Consumer Credit Control*, Vol. 1 at p 1104[1], now edited by Paul Dobson.

47 In a telephone conversation on 30 April 1999 with the Secretary of the Sub-committee which was recorded in a letter from the Secretary to Professor Goode dated 22 June 1999.

48 In an e-mail dated 30 April 1999 to the Secretary of the Sub-committee.

49 In an e-mail dated 8 May 1999 to the Secretary of the Sub-committee.

50 [1893] 2 QB 318.

property would pass to the hirer. The court held that since the "hirer" was bound to make that payment, the agreement in question was a contract of sale. On the other hand, in *Helby v Matthews*,[51] the hirer hired a piano upon terms that he paid 36 instalments of rental and, on paying the last instalment, the property of the piano would pass to him. In addition, the hirer was free to terminate the agreement at any time. The House of Lords held that the agreement in question was a hire purchase agreement since the hirer was not bound to buy the piano. The English Court of Appeal in a recent case, *Forthright Finance Ltd v Carlyle Finance Ltd*,[52] held an agreement to be a conditional sale agreement because the "hirer" was contractually obliged to pay all the contractual instalments. In this case, the "hirer" could exercise an option to decline to receive the title after paying all instalments. Despite this, the Court of Appeal still held that it was a conditional sale agreement because the *"option not to take title, which one would only expect to be exercised in the most unusual circumstances, does not affect the true nature of the agreement".*[53]

2.68 Professor Paul Dobson also stated, *"[i]n a hire-purchase agreement, the debtor is not committed to acquiring title to the property".*[54]

2.69 However, it must be pointed out that paras (b)(ii) and (iii) of the definition in section 15 of the 1973 Act may not necessarily be in line with the important element of hire purchase that the hirer has the right but not the obligation to buy the goods. Paragraph (b)(ii) refers to *"the doing of any other specified act by any party to the agreement".* "[A]ny party to the agreement" can be any party other than the hirer, and the doing of the specified act by that party will trigger the passing of the property. Whether that party does that specified act or not may be beyond the control of the hirer. The same applies to "the happening of any other specified event" of para (b)(iii), since the happening of that specified event may be beyond the control of the hirer. The happening of that specified event will also trigger the passing of the property. Therefore, under some circumstances, the hirer may be obliged to buy the goods because the "doing of the specified act" in para (b)(ii) or the "happening of any other specified event" in para (b)(iii) may be beyond his control. Such a scenario is practically indistinguishable from a conditional sale agreement under which the buyer is obliged to buy the goods.

2.70 Professor Goode is of the view that the definition in the 1973 Act was drafted *"to cover all types of situation in which property would pass where the hirer nevertheless had the right to prevent this happening".*[55] Even though Professor Goode stated that the important element of a hirer's right but not obligation to buy the goods was *"covered by saying that a hire purchase*

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51 [1895] AC 471.

52 [1997] 4 All ER 90.

53 [1997] 4 All ER 90, at p 98. The court left open the question whether contracts which required a "hirer" to pay all instalments (ie no right to terminate during the hiring period) and to exercise a positive option to acquire title for a nominal payment, also constituted conditional sale agreements. But as mentioned above, it was held in *Close Asset Finance Ltd v Care Graphics Machinery Ltd* (Times L R 21 March 2000) that such an agreement was not an agreement to buy.

54 Francis Bennion, *Consumer Credit Control,* Vol 1 at p 1104[1], now edited by Paul Dobson.

55 In a fax dated 18 May 1999 from Professor Goode to the Secretary of the Sub-committee.

agreement is an agreement 'other than a conditional sale agreement' [in the definition of the 1973 Act]",[56] it would be appropriate for Hong Kong to spell out this important element explicitly for the sake of certainty and the avoidance of doubt.

Other aspects of the definition in the 1973 Act

2.71 Section 15 of the 1973 Act defines a hire purchase agreement as an agreement under which the property in the goods will pass "if the terms of the agreement are complied with" and "one or more of the following occurs ..."[57] These two elements overlap with each other. Sub-paras (i), (ii) and (iii) should already form part of "the terms of the agreement". Once all the terms have been complied with, there would by definition be no further terms requiring "the exercise of an option", "the doing of any other specified act" or "the happening of any other specified event" before property is to pass. Any such "further" terms would already have been complied with.

2.72 Furthermore, Professor Goode is of the view that "the definition is over-elaborate".[58] The definition of "hire purchase agreement" in the 1973 Act is wider than that in the Hire Purchase Act 1965 and in effect, it avoids the operation of the buyer in possession exception to the nemo dat rule, but yet is still confined to the scope of bailment. Nonetheless, because of the reasons mentioned above, the definition in the 1973 Act may not be appropriate for Hong Kong.

The definition for Hong Kong

2.73 On the basis of the elements of a definition of "hire purchase agreement" identified by Professor Goode, he suggested that:

> *"it would be sufficient to say that a hire purchase agreement is an agreement, or a combination of agreements, by which goods are supplied on hire and the hirer has the right, but not obligation to buy the goods."*[59]

2.74 For Hong Kong, a wider definition is preferred, but it should not be outside the scope of bailment since the basis of hire purchase must be hire. In addition, the important element that the hirer has the right but not obligation to buy the goods must be reflected unequivocally in the definition. In addition, it is preferable that the definition is concise. To this end, it is recommended that the definition suggested by Professor R M Goode, which includes all the

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[56] In a fax dated 18 May 1999 from Professor Goode to the Secretary of the Sub-committee.

[57] The other criteria in the definition should also be fulfilled in order to be a hire purchase agreement.

[58] In a fax dated 18 May 1999 from Professor Goode to the Secretary of the Sub-committee. For example, he mentioned that subparagraphs (ii) and (iii) could be replaced by the simpler phrase "the fulfilling of the conditions specified in the agreement". (In a telephone conversation on 30 April 1999 with the Secretary of the Sub-committee which was recorded in a letter from the Secretary to Professor Goode dated 22 June 1999.)

[59] In a fax dated 18 May 1999 from Professor Goode to the Secretary of the Sub-committee.

required elements and yet without compromising conciseness, is appropriate for Hong Kong.

Recommendation 4

We recommend that:

(a) a hire purchase agreement should be treated in the Recommended Legislation as a type of contract for the supply of goods; and

(b) it should be defined to mean an agreement, or a combination of agreements, by which goods are supplied on hire and the hirer has the right, but not obligation, to buy the goods.

What are "goods"?

Definition in Cap 26

2.75 In section 2 of Cap 26, "goods" is defined as including:

> *"all chattels* personal *other than things in action and money. The term includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale".*

2.76 This is a general definition and makes it clear that "goods" includes "all chattels personal other than things in action".

Australia

2.77 In section 4 of the 1974 Act, "goods" is defined to include ships, aircraft, other vehicles, animals, minerals, trees, crops, gas and electricity. This is an inclusive definition and the word "goods" is *"defined in terms based upon, but wider than, the definition in the sale of goods legislation".*[60] Therefore, reference should be drawn to the more general definition of "goods" in the sale of goods legislation in each individual state or territory in Australia. For example, in section 5(1) of the Sale of Goods Act (NSW), "goods" is defined in identical terms to those in Hong Kong.

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[60] John Goldring, Laurence Maher and Jill McKeough, *Consumer Protection Law in Australia*, 3rd Ed, 1987, at para 217.

New Zealand

2.78 In section 2(1) of the 1993 Act, "goods" is defined to include goods attached to or incorporated in real or personal property, ships, aircraft, vehicles, animals, minerals, trees, crops, etc. This is also only an inclusive definition, and reference should be drawn to the more general definition of "goods" in the Sale of Goods Act 1908.

England and Wales

2.79 In section 18(1) of the 1982 Act, "goods" is defined as follows:

> *"'goods' includes all personal chattels, other than things in action and money, and as regards Scotland all corporeal moveables; and in particular 'goods' includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before the transfer bailment or hire concerned or under the contract concerned".*

2.80 This definition is almost identical to that in the 1979 Act. "Goods" is not defined in the 1973 Act and the definitions in the 1979 Act and the 1982 Act should be followed.

Conclusion

2.81 In Hong Kong, for other types of supply of goods, the more general definition of "goods" in Cap 26 should be adopted, instead of the inclusive definitions found in the 1974 Act (Australia) and the 1993 Act (New Zealand), for the sake of clarity and consistency with Cap 26.

Computer software

2.82 In Hong Kong, computers are more and more commonly used both at home and in business (including non-profit organisations, such as, government, charitable groups, etc). However, it is not clear whether the definition of "goods" in Cap 26 covers computer software and there is no Hong Kong authority on this.

2.83 A physical copy of computer software is very often supplied to a customer by way of sale. For the present purpose, we focus on the supply of goods other than by way of sale. Computer software as the subject matter of a contract of hire or hire purchase agreement is relatively uncommon. However, computer software can be the subject matter of a contract for transfer of property in goods as defined in this chapter, such as, contracts for work and materials or other types of contracts for transfer of property in goods. The cases cited in the following paragraphs mainly concern sales of computer

software. Nonetheless, since the emphasis of the following discussion is whether computer software is "goods", the analysis should also be applicable to the supply of goods other than sale.

Hardware vs software[61] *- the common law position*

2.84 Computer hardware is a tangible personal chattel and therefore should be goods within the definition of "goods" in Cap 26.

2.85 As for a computer system comprising both hardware and software, *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd,*[62] an Australian case, held that this was "goods" within the definition of the Sale of Goods Act 1923 (NSW) and the Trade Practices Act 1974. In this case, the plaintiff acquired a complete computer system comprising hardware and software and there were defects in the computer system. The question was whether the computer system was "goods". At p 54, Rogers J held:

> *"Confronting the question specifically, I come to the conclusion that a sale of a computer system, comprising both hardware and software, as in the present case, does constitute a sale of goods within the meaning of both the [Trade Practices Act 1974] and the [Sale of Goods Act 1923 (NSW)]. There is a sale of tangible chattels, a transfer of identifiable physical property. It is true that it is necessary for the effective working of the system that there should be comprised within it software. That does not disqualify the aggregate operative system from the appellation or description of 'goods'."*

2.86 The English Court of Appeal endorsed this case in *St Albans City and District Council v International Computers Ltd*.[63] Sir Iain Glidewell stated[64] (obiter) that *"that decision was in my respectful view clearly correct".* In this case, the plaintiff local authority entered into a contract with the defendant company for the supply of a computer system and there was an error in the software. The Court of Appeal held that there was an *"express contractual obligation to supply the plaintiffs with software which would enable them accurately to complete the return by that date"*[65] and the defendant had breached that express term.

2.87 Sir Iain Glidewell went on to express his opinion as to whether, assuming there was no such an express term, a term to the same effect (ie as to quality or fitness for purpose) would be implied either by statutes or general contract law. Sir Iain Glidewell first decided whether such a term was implied by statutes and said:

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61 In *The New Shorter Oxford English Dictionary* (Thumb Index Edition), "hardware" is defined as "the physical components of a computer" and "software" is defined as "the programs and other operating information used by a computer".

62 [1983] 2 NSWLR 48.

63 [1996] 4 All ER 481.

64 At p 493.

65 [1996] 4 All ER 481, at p 487.

"In both the Sale of Goods Act 1979, s61, and the Supply of Goods and Services Act 1982, s18, the definition of goods includes 'all personal chattels other than things in action and money'. Clearly, a disk is within this definition. Equally clearly, a program, of itself, is not . …

There is no English authority on this question, and indeed we have been referred to none from any common law jurisdiction . …

Suppose I buy an instruction manual on the maintenance and repair of a particular make of car. The instructions are wrong in an important respect. Anybody who follows them is likely to cause serious damage to the engine of his car. In my view, the instructions are an integral part of the manual. The manual including the instructions, whether in a book or a video cassette, would in my opinion be 'goods' within the meaning of the 1979 Act, and the defective instructions would result in a breach of the implied terms in s14.

If this is correct, I can see no logical reason why it should not also be correct in relation to a computer disk onto which a program designed and intended to instruct or enable a computer to achieve particular functions has been encoded. If the disk is sold or hired by the computer manufacturer, but the program is defective, in my opinion there would prima facie be a breach of the terms as to quality and fitness for purpose implied by the 1979 Act or the 1982 Act."[66] (emphasis added)

2.88 However, in this case, an employee of the defendant went to the plaintiffs' premises, taking with him a disk encoded with the required program, and transferred the program into the computer. Since Sir Iain Glidewell was of the view that the program itself was not "goods" within the terms of either the 1979 Act or the 1982 Act, the statutory implied terms in those acts did not apply to this case. But he was of the opinion that a term as to fitness for purpose would be implied under general contract law.

2.89 In the United States, the Court of Appeals for the 3d Circuit held[67] that software in a physical medium was "goods" within the meaning of the Uniform Commercial Code:

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a 'good', but when transferred to a laser-readable disc becomes a readily

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66 [1996] 4 All ER 481, at p 493.

67 *Advent Systems Ltd v Unisys Corp* (1991) 925 F 2d 670.

> *merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.*
>
> *That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace . ..*
>
> *The importance of software to the commercial world and the advantages to be gained by the uniformity inherent in the UCC are strong policy arguments favoring inclusion. The contrary arguments are not persuasive, and we hold that software is a 'good' within the definition in the Code."*[68] (emphasis added)

2.90 Even though the US Court of Appeals stated that "software [was] a 'good'", it is clear from reading the passages quoted that the court meant software in a physical medium.

2.91 With the possibility and growing popularity of on-line distribution of informational products, the question as to whether software supplied through the Internet is "goods" arises. It was held in *ASX Operations Pty Ltd and others v Pont Data Australia Pty Ltd,*[69] an Australian case, that information supplied by electronic means was not "goods" for the Trade Practices Act 1974. At para 20, Judge Lockhart stated:

> *"it does not follow …that it should be read as if there was a further inclusion, by way of extension of the ordinary meaning of 'goods', so as to draw within the definition encoded electrical signals".*

Summary and options

2.92 It should be safe to say that hardware is "goods". As for a computer system comprising hardware and software (such as the boot-up, start-up or operating system program stored on computer chips or disk inside a computer), it may be regarded as "goods" within Cap 26 since the hardware and software can be considered as constituting one entity. The *Toby* case is the authority for this.

2.93 The sale (supply) of a floppy disc containing computer software is similar to a sale of a compact disc containing recorded music or a videotape containing a movie. There is a sale (supply) of a chattel embodied with a copy of "work" in which intellectual property rights exist in each case. The fact that the "work" of which a copy is sold (supplied) also constitutes intellectual property does not undermine the fact that the physical medium containing the

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68 (1991) 925 F 2d 670, at p 675-676.

69 (1990) 27 FCR 460.

"work" is a chattel and, therefore, "goods".[70] The obiter of Sir Iain Glidewell in the *St Albans* case is the authority for this. As to software supplied through the Internet or other electronic means, it is more difficult to argue that they are "goods" within Cap 26 since they are not in a tangible medium. The *ASX Operations* case is the authority for this.

2.94 None of the cases referred to are from Hong Kong and the remarks in the *St Albans* case on the issue in question are only obiter dictum. Therefore, in Hong Kong the position remains uncertain. The Recommended Legislation could therefore define "goods" to make it clear that computer systems comprising hardware and software and tangible mediums containing software do not disqualify the systems and the mediums respectively from being "goods". Note that such a definition will be different from that in Cap 26 and there will be inconsistency between the two definitions. The definition in Cap 26 may then have to be amended consequentially.

2.95 Another option is to leave it to the courts to decide. The advantages of this approach are that this is in line with Australia, New Zealand and England and Wales and that there is no need to consider whether to amend the definition of "goods" in Cap 26. However, the disadvantage is that the issue remains unclear.

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[70] However, it must be noted that according to Mr Henry Carr and Mr Richard Arnold, a compact disc of music can be played in private without infringing copyright. Every time computer software is used, copyright of it will be infringed if the user is not licensed. Because whenever a computer software is used as it is run in a computer, copying has to take place since the software has to be copied internally by the computer. Such copying is a restricted act from the copyright point of view. Therefore, a user of a standard software must obtain a license before using it. The requirement of a license should not alter the fact that there is a contract of sale (supply) of goods (copy of computer software in physical medium) between the retailer and the customer which covers the physical medium and the electro-magnetic encoding of the program. This is similar to a sale (supply) of compact disc. The difference is that the customer of the compact disc can use it without a license, but the customer of the computer software requires a license to use it. See Carr & Arnold, *Computer Software: Legal Protection in the United Kingdom,* 2nd Ed, 1992, Chapter 8, at p 144.

As to the relationship between a license and supply of the computer software, it was held in *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd,* 1996 SLT 604, that the supply of proprietary software for a price was a single contract, although it contained elements of nominate contracts such as sale and the grant of a license, and that it was an essential feature of the transaction that the supplier undertook to make available to the customer both the medium on which the program material was recorded and the right of access to and use of the software. Lord Penrose said at p 609H: *'It is in my opinion unacceptable to analyse the transaction in this case as if it were two separate transactions relating to the same subject matter. There is but one contract …*" See also Carr & Arnold, *Computer Software: Legal Protection in the United Kingdom,* 2nd Ed, 1992, Chapter 8, and B W Napier, "The Future of Information Technology Law", (1992) CLJ 46.

In the US, a "shrink-wrap licence" is adopted by which the terms of the licence are printed on the package and can be seen through clear plastic film. It is stated on the package that if the customer open the package, he is deemed to accept the terms of the licence. See Carr & Arnold, *Computer Software: Legal Protection in the United Kingdom*, 2nd Ed, 1992, para 8.2.2 for the legal problem of "shrink-wrap licence".

In Hong Kong, software is usually supplied with the terms of the licence appears on the screen of the computer when the customer tries to load the software onto his computer. The customer has to click "agree" before he can successfully load the software. For some software companies, like Microsoft, the customer can return the software for refund if he does not accept the terms of the license.

Conclusion

2.96 Computers are commonly used for both domestic and business purposes in Hong Kong, and are influential in many aspects of everyday life. Users of software, whether consumers or not, should be protected just like users of many other goods and they should not have to put up with uncertainty. Certainty and predictability in the law are important.

2.97 However, expanding the definition of "goods" to put beyond doubt that it covers computer systems comprising software, and physical mediums containing software, only addresses one aspect of software use. It seems reasonable that users of software should be protected in the same way as users of any other goods. However, it may be preferable to await a more comprehensive study of this topic, covering issues like software licensing and Internet contracts.[71] A new and highly technical topic like this deserves a separate study in its own right. Piecemeal changes may not necessarily be to the benefit of software users. In addition, according to the Consumer Council,[72] the number of complaints about software is not significant. A table containing the complaint statistics on software is at Annex 3.

2.98 It must be pointed out that the discussion of the supply of computer software in this Paper is not intended to cover all matters relating to computer software. Our concern is limited to the implied terms for contracts for supply of computer software.

Recommendation 5

We recommend that the definition of "goods" in Cap 26 should be followed.

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[71] The draft Article 2B of the Uniform Commercial Code of the United States is intended to provide a comprehensive framework for software licensing and Internet contracts. The provisions include implied terms as to merchantability and quality of computer program.
In view of the growth of the information economy in US, the National Conference of Commissioners on Uniform State Laws and the American Law Institute have proposed to add to the Uniform Commercial Code, a new Article 2B which would validate information licences and provide new rules concerning electronic contracting for information products and services.
The scope to the new Article 2B is wide and is available at <http://www.law.upenn.edu/library/ulc/ucc2/2b398.htm> (draft dated March 1998). It involves on-line and Internet transactions in software, databases and also traditional copyright works in digitised form. The new Article 2B regulates information resources on-line and in hard copy for both business and consumer transactions by way of a licensing contract.
The new Article 2B is based on the framework for sale transaction in Article 2 of the Uniform Commercial Code and it consists of 7 parts: General Provisions; Formation; Construction; Warranties; Transfer of interests and rights; Performance; and Remedies. Article 2B aims to provide a comprehensive framework for software licensing and Internet contracts.
For discussion of the draft Article 2B, see Evans & Fitzgerald, "Information Transactions under UCC Article 2B: The Ascendancy of Freedom of Contract in the Digital Millennium?", (1998) UNSWLJ 404.

[72] In a telephone conversation on 29 Oct 1999 between Mr K M Li, Deputy Chief Executive of the Consumer Council and the Secretary for the Sub-committee.

Chapter 3

Implied terms to be included in the Recommended Legislation – implied terms about title, etc

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Overview

3.1 In this and the next three chapters, we discuss the implied terms to be included in the Recommended Legislation for contracts for supply of goods (other than sale). There are four such implied terms and we discuss one in each chapter in the following sequence:

(a) implied terms about title, etc – Chapter 3;
(b) correspondence with description – Chapter 4;
(c) implied terms about quality or fitness – Chapter 5;
(d) supply by sample – Chapter 6.

3.2 In this chapter, we first examine the implied terms about title in section 14 of the Sale of Goods Ordinance (Cap 26). Then, in respect of these implied terms, we examine the three types of contracts for supply of goods recommended in Chapter 2, namely contracts for transfer of property in goods, contracts of hire and hire purchase agreements.

3.3 For each of these three types of contracts, we first examine the common law position in Hong Kong and then the positions in Australia, New Zealand and England and Wales. We also examine the relevant comments of academics and overseas law reform bodies.

3.4 We then make recommendations for each of the three types of contracts as follows:

*(a) contracts for transfer of property in goods – **Recommendation 6**;*
*(b) contracts of hire – **Recommendation 7**;*
*(c) hire purchase agreements – **Recommendation 8**.*

Undertakings as to title under Cap 26

3.5 The undertakings as to title are set out in section 14 of Cap 26 which reads as follows:

> "*(1) In every contract of sale, other than one to which subsection (2) applies, there is –*
>
> *(a) an implied condition on the part of the seller that in the case of the sale, he has a right to sell the goods, and in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass; and*
>
> *(b) an implied warranty that the goods are free, and will remain free until the time when the property is to pass, from any charge or encumbrance not disclosed or known to the buyer before the contract is made and that the buyer will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.*
>
> *(2) In a contract of sale, in the case of which there appears from the contract or is to be inferred from the circumstances of the contract an intention that the seller should transfer only such title as he or a third person may have, there is –*
>
> *(a) an implied warranty that all charges or encumbrances known to the seller and not known to the buyer have been disclosed to the buyer before the contract is made; and*
>
> *(b) an implied warranty that neither –*
>
> *(i) the seller; nor*
> *(ii) in a case where the parties to the contract intend that the seller should transfer only such title as a third person may have, that person; nor*
> *(iii) anyone claiming through or under the seller or that third person otherwise than under a charge or encumbrance disclosed or known to the buyer before the contract is made,*
>
> *will disturb the buyer's quiet possession of the goods.*"

3.6 There are two sets of undertakings to provide for two situations. The first is where a seller agrees to transfer a good title to the goods (the usual case). The second is where a seller only agrees to transfer such title as he or a third person may have (one example is the sale by a receiver of goods in the possession of a company under receivership). In the first case, there is an implied *condition* that the seller has the right to sell the goods at the time of sale or, in the case of an agreement to sell, that he will have a right to sell the goods at the time when property is to pass.[1] There are also implied *warranties* that the goods are free and will remain free from any charge or encumbrance not disclosed or known to the buyer before the contract is made; and that the buyer will enjoy quiet possession of the goods except in respect of disturbance by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or so known.[2]

3.7 In the second case, there is only an implied *warranty* that all charges or encumbrances known to the seller and not known to the buyer have been disclosed to the buyer before the contract is made.[3] There is a further implied *warranty* that the buyer will enjoy quiet possession of the goods.[4]

Contracts for the transfer of property in goods

3.8 As discussed in Chapter 2, contracts for the transfer of property in goods cover various types of contracts and the two major types are barter and contracts for work and materials. In the discussion in this chapter and the next three chapters, these two types of contracts are singled out for the sake of discussion. But the implied terms to be recommended should apply generally to all kinds of contracts for the transfer of property in goods.

Common law position in Hong Kong

Barter

3.9 Before the enactment of the Sale of Goods Act 1893, it was generally supposed that at common law the obligations of a supplier of goods were the same as those of a seller of goods.[5] Accordingly, as the Sale of Goods Act 1893 was to put the principles of law derived from the cases into a

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1 Cap 26, s14(1)(a).

2 S14(1)(b). See *Microbeads A G v Vinhurst Road Markings Ltd* [1975] 1 WLR 218 where the Court of Appeal held that the implied warranty of quiet possession was operative not only at the time when title in the goods was to pass but afterwards as well. The relevant provision of the Sale of Goods Act 1893 was amended by the Supply of Goods (Implied Terms) Act 1973 after the date of the case, but the reasoning of the Court of Appeal applies to the new wording in the same way as to the old.

3 S14(2)(a).

4 S14(2)(b). The seller, the person whose title the seller purports to sell, or anyone claiming through or under either of them otherwise than under a charge or encumbrance disclosed or known to the buyer before the contract was made, will not disturb the buyer's quiet possession of the goods.

5 Lord Blackburn, *Blackburn's Contract of Sale,* 3rd Ed, 1910, at p ix.

statutory form,[6] the Sale of Goods Act 1893 in its original version should also reflect the legal position of contracts of barter. As Cap 26 was modelled on the Sale of Goods Act 1893, Cap 26 in its original version should therefore also reflect the legal position of contracts of barter in Hong Kong.

3.10 There is a view that "*apart from statute, the rules of law relating to sales apply in general to contracts of barter or exchange; but the question has been by no means fully worked out.*"[7] It would seem sensible that the terms to be implied in such contracts should be enumerated and made plain in legislation. Before making any recommendation, we will first turn to the experiences in other jurisdictions.

Contracts for work and materials

3.11 The problem with contracts for work and materials is, to a large extent, the same as that of barter. The obligations of a supplier at common law in respect of materials supplied were generally regarded as the same whether the contract was classified as one of sale or of work and materials. As to the obligations of the supplier, the main difference between a contract for work and materials and a contract of sale is that terms are only implied into the former in accordance with the general law of contract and not under Cap 26.[8]

(a) general position as to implied terms

3.12 The obligation of a supplier of materials, under such a contract, was considered in detail in *Young & Marten Ltd v McManus Childs Ltd.*[9] In this case, arguments were put by members of the House of Lords in favour of eliminating any differences between the obligations of the supplier of materials under a contract for work and materials and those under a contract of sale. One argument was that a supplier would normally be able to pass his liability on to the person from whom he purchased the materials in question and so would be no worse off, whereas the person supplied would probably have no remedy if he were denied a remedy in contract against the person supplying him.

3.13 The House of Lords held that conditions or warranties to be implied in contracts for work and materials should be the same as those for contracts of sale. Lord Wilberforce said in relation to the contract for work and materials in question:

> "*neither analysis nor authority supports the suggestion that, other circumstances apart, the conditions or warranties to be*

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6 MacKenzie Chalmers, *The Sale of Goods Act 1893,* 1894, see the Introduction. Sir MacKenzie Chalmers was the draftsman of the Sale of Goods Act 1893.

7 Michael Mark, *Chalmers Sale of Goods* ,18th Ed, 1981, at p 82-83.

8 For the nature of the conditions and warranties implied into a contract for work and materials and the circumstances in which such conditions and warranties will be implied, see *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454*, Gloucestershire County Council v Richardson* [1969] 1 AC 454.

9 [1969] 1 AC 454.

implied should be any different from those which would have arisen has this contract been for sale simpliciter."[10]

3.14 Lord Upjohn said such differences would be "*most unsatisfactory, illogical, and indeed a severe blow to any idea of a coherent system of common law …*" Lord Pearce said:

> "*The cases which preceded and crystallised in the Sale of Goods Act, 1893, do not, as far as conditions or warranties are concerned, seem to show any clear consciousness of a difference in principle between a sale of goods and a contract for labour and materials.*"[11]

(b) position as to undertaking as to title in particular

3.15 It would therefore appear that the terms implied in a contract for work and materials are, so far as the materials are concerned, no less stringent than those implied in a contract of sale. However, there are few direct cases on the undertaking as to title of a supplier under a contract for work and materials, but based on the above discussion, it is likely that a term similar to that for a contract of sale would be implied. Despite all these, to enhance clarity, overall certainty and access to the law, it would seem preferable to have the rules set out in legislation.

Australia

Section 69 - implied undertakings as to title, encumbrances and quiet possession

3.16 Section 69(1)(a) of the 1974 Act[12], which is similar to the sale of goods legislation at the State and Territory level,[13] contains implied undertakings as to title, encumbrances and quiet possession:

> "*(1) In every contract for the supply of goods by a corporation to a consumer, other than a contract to which subsection (3) applies, there is:*
>
> *(a) an implied condition that, in the case of a supply by way of sale, the supplier has a right to sell the*

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10 [1969] 1 AC 454, at p 479B. It must be pointed out that in most other contexts, when the law lords referred to "warranty", they used it in a generic sense, not as opposed to "condition", for example, "*he would have had a warranty under section 14(2) [of the Sale of Goods Act]*" at p 466G, and "*section 14(2) of the Sale of Goods Act, 1893, would have applied and entitled the respondents to succeed in their claim for breach of warranty that the titles were of good quality*" at p 471G.

11 [1969] 1 AC 454, at p 470E.

12 For the 1974 Act in general, see Chapter 1.

13 For example, section 17 of the Sale of Goods Act 1923 (NSW): Implied undertaking as to title, etc. In Australia, there is no sale of goods legislation at the Commonwealth (federal) level, but each State and Territory has its own sale of goods legislation.

goods, and, in the case of an agreement to sell or a hire-purchase agreement, the supplier will have a right to sell the goods at the time when the property is to pass;

(b) an implied warranty that the consumer will enjoy quiet possession of the goods except so far as it may lawfully be disturbed by the supplier or by another person who is entitled to the benefit of any charge or encumbrance disclosed or known to the consumer before the contract is made; and

(c) in the case of a contract for the supply of goods under which the property is to pass or may pass to the consumer - an implied warranty that the goods are free, and will remain free until the time when the property passes, from any charge or encumbrance not disclosed or known to the consumer before the contract is made.

(2) A corporation is not, in relation to a contract for the supply of goods, in breach of the implied warranty referred to in paragraph (1)(c) by reason only of the existence of a floating charge over assets of the corporation unless and until the charge becomes fixed and enforceable by the person to whom the charge is given.

(3) In a contract for the supply of goods by a corporation to a consumer in the case of which there appears from the contract or is to be inferred from the circumstances of the contract an intention that the supplier should transfer only such title as he or she or a third person may have, there is:

(a) an implied warranty that all charges or encumbrances known to the supplier and not known to the consumer have been disclosed to the consumer before the contract is made; and

(b) an implied warranty that:

(i) the supplier;

(ii) in a case where the parties to the contract intend that the supplier should transfer only such title as a third person may have, that person; and

(iii) anyone claiming through or under the supplier or that third person otherwise than

under a charge or encumbrance disclosed or known to the consumer before the contract is made;

will not disturb the consumer's quiet possession of the goods."

(a) scope of section 69

3.17 With regard to the undertaking as to the right to pass title, section 69(1)(a) only covers sale, agreements to sell and hire purchase agreements, and implies a condition that a supplier has a right to sell or will have a right to sell the goods at the time when the title is to pass. It does not cover other types of contracts under which title of goods is passed, such as, barter and other types of contracts for the transfer of property in goods.

3.18 As to the implied warranties of quiet possession and freedom from encumbrance in section 69(1)(b) and (c), they cover all types of "supply" of goods as defined in section 4, including sale, exchange, lease, hire and hire purchase. Similarly, in the case of a transfer of limited title, the implied warranties of quiet possession and disclosure of known charges or encumbrances to the transferee in section 69(3), cover all types of "supply" of goods as defined. As mentioned in Chapter 2, section 74 separately provides for some implied terms for contracts for work and materials. But it does not provide for undertakings as to title, quiet possession or freedom from encumbrance.[14]

(b) substance of section 69

3.19 In substance, section 69(1) and (3) is similar to section 14 of Cap 26. There is no equivalent in Cap 26, however, to section 69(2) of the 1974 Act, which makes clear that a floating charge over the assets of the corporation will not by itself be in breach of the implied warranty as to freedom from encumbrance in subsection (1)(c).

(c) non-consumer transactions

3.20 As the 1974 Act only applies to the supply of goods to consumers, the supply of goods by way of barter, and contracts for work and materials to non-consumers is governed by common law. For barter, no direct authority can be found. However, the Australian court may follow the views of Blackburn[15] and Chalmers[16] to the effect that the common law obligations of a seller apply to a supplier under a contract of barter. No direct authority can be found on undertakings as to title in contracts for work and materials, but terms as to fitness for purpose and good quality have been

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14 See Chapter 5 for the text of section 74.

15 Lord Blackburn, *Blackburn's Contract of Sale,* 3rd Ed, 1910, at p ix.

16 Michael Mark, *Chalmers Sale of Goods,* 18th Ed, 1981, at p 82-83.

implied in contracts for work and materials.[17] Therefore, it is likely that the Australian court may also imply an undertaking as to title similar to that implied in sale of goods contracts.

New Zealand

Section 5 – Guarantees as to title

3.21 Section 5 of the 1993 Act[18], which is similar to the equivalent provision in the New Zealand Sale of Goods Act 1908,[19] provides for a guarantee as to title in the supply of goods in trade to a consumer. It reads as follows:

> "*(1) Subject to section 41 of this Act, the following guarantees apply where goods are supplied to a consumer:*
>
> *(a) That the supplier has a right to sell the goods; and*
>
> *(b) That the goods are free from any undisclosed security; and*
>
> *(c) That the consumer has the right to undisturbed possession of the goods, except in so far as that right is varied pursuant to –*
>
> *(i) A term of the agreement for supply in any case where that agreement is a hire purchase agreement within the meaning of the Hire Purchase Act 1971; or*
>
> *(ii) A security, or a term of the agreement for supply, in respect of which the consumer has received –*
>
> *(A) Oral advice, acknowledged in writing by the consumer, as to the way in which the consumer's right to undisturbed possession of the goods could be affected, sufficient to enable a reasonable consumer to understand the general nature and effect of the variation; and*

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17 *Halsbury's Laws of Australia*, para 40-415, note 1; para 110-2165, notes 8-9. *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46; *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454.

18 For the 1993 Act in general, see Chapter 1.

19 Section 14. Implied undertaking as to title, etc.

(B) A written copy of the agreement for supply or security, or a written copy of the part thereof which provides for the variation.

(2) A reference in subsection (1)(a) of this section to a 'right to sell' goods means a right to dispose of the ownership of the goods to the consumer at the time when that ownership is to pass.

(3) An 'undisclosed security' referred to in this section means any security that was neither disclosed to the consumer in writing before he or she agreed to the supply nor created by or with the express consent of the consumer.

(4) Nothing in subsection (1)(a) or (1)(b) of this section shall apply in any case where the goods are only hired or leased.

(5) Where the goods are only hired or leased, the guarantee set out in subsection (1)(c) of this section shall confer a right to undisturbed possession of the goods only for the period of the hire or lease.

(6) Part II of this Act gives the consumer a right of redress against the supplier where the goods fail to comply with any guarantee in this section."

(a) guarantee as to a right to sell

3.22 Where goods are supplied to a consumer, the supplier guarantees that he has right to sell the goods (section 5(1)(a)). According to section 5(2), this means that the supplier has a right to dispose of the ownership of the goods to the consumer at the time when that ownership is to pass. Therefore, it is clear that the guarantee as to a right to sell applies to sales, agreements to sell, and hire purchase. It is also arguable that this guarantee also applies to "supply" of goods as defined in section 2 (including gift, sale, exchange, lease, hire and hire purchase and by virtue of section 15, contracts for work and materials) so long as there is passing of ownership of the goods. In other words, it applies to gift, exchange, and contracts for work and materials. However, it is also arguable that the word "sell" in "right to sell" limits itself to sale.

(b) guarantee as to freedom from undisclosed security

3.23 The guarantee as to freedom from undisclosed security in section 5(1)(b) applies to the "supply" of goods as defined, including exchange and contracts for work and materials but not hire and lease

according to section 5(4). "Undisclosed security" means[20] any security that was neither disclosed to the consumer in writing before he or she agreed to the supply nor created by or with the express consent of the consumer. This is similar to the corresponding warranty in section 14(1)(b) of Cap 26.

(c) guarantee regarding undisturbed possession

3.24 As to the guarantee regarding undisturbed possession of the goods under section 5(1)(c), this applies to the "supply" of goods as defined, including exchange and contracts for work and materials. This right of undisturbed possession can be varied following the required formalities in section 5(1)(c)(i) and (ii). These required formalities are not set out in the equivalent warranty in section 14 of Cap 26.

(d) non-consumer transactions

3.25 As the 1993 Act only applies to the supply of goods to a consumer, the supply of goods by way of barter, and contracts for work and materials to non-consumers is governed by common law. In New Zealand, the law relating to barter is undeveloped. However, the court "*seems inclined to deal with such contracts as if they were analogous to contracts of sale*".[21] No direct authority can be found on implied terms as to title in contracts for work and materials. However, terms as to fitness for purpose and good quality have been implied.[22] Therefore, the New Zealand court may imply a term concerning title similar to that implied in sale of goods contracts.

England and Wales

Section 2 of the 1982 Act – Implied terms about title, etc

3.26 A "contract for the transfer of goods" is defined.[23] Implied terms as to title in contracts for the transfer of property in goods are stipulated in section 2 of the 1982 Act which is similar to section 12 of the Sale of Goods Act 1979[24] (the "1979 Act"). Section 2 reads as follows:

> "*(1) In a contract for the transfer of goods, other than one to which subsection (3) below applies, there is an implied condition on the part of the transferor that in the case of a transfer of the property in the goods he has a right to transfer the property and in the case of an agreement to*

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20 Section 5(3).

21 *The Laws of New Zealand*, Vol 23 para 54 and note 7.

22 *The Laws of New Zealand*, Vol 2 para 74. *Batchelor's Pram House Ltd v Mckenzie Brothers Electrical Ltd* [1962] NZLR 545 at p 547.

23 The 1982 Act, s1(2). For the definition, see Chapter 2.

24 Implied terms as to title etc. Under sections 12-15 of the Sale of Goods Act 1979, terms as to title, correspondence with description or sample, merchantability, and fitness for purpose or purposes are implied into a contract of sale.

transfer the property in the goods he will have such a right at the time when the property is to be transferred.

(2) In a contract for the transfer of goods, other than one to which subsection (3) below applies, there is also an implied warranty that -

(a) the goods are free, and will remain free until the time when the property is to be transferred, from any charge or encumbrance not disclosed or known to the transferee before the contract is made, and

(b) the transferee will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known.

(3) This subsection applies to a contract for the transfer of goods in the case of which there appears from the contract or is to be inferred from its circumstances an intention that the transferor should transfer only such title as he or a third person may have.

(4) In a contract to which subsection (3) above applies there is an implied warranty that all charges or encumbrances known to the transferor and not known to the transferee have been disclosed to the transferee before the contract is made.

(5) In a contract to which subsection (3) above applies there is also an implied warranty that none of the following will disturb the transferee's quiet possession of the goods, namely –

(a) the transferor;

(b) in a case where the parties to the contract intend that the transferor should transfer only such title as a third person may have, that person;

(c) anyone claiming through or under the transferor or that third person otherwise than under a charge or encumbrance disclosed or known to the transferee before the contract is made."

3.27 In section 2(1), there is an implied condition that the transferor of goods has a right to transfer the property and, in the case of an agreement to transfer, he will have such a right when the property is to be transferred. There are warranties of freedom from encumbrance and quiet possession

except when the charge or encumbrance has been disclosed to the transferee (section 2(2)). As to a transfer of limited title, there are also warranties of disclosure of known charges or encumbrances to the transferee, and of quiet possession save as to charges or encumbrances disclosed to the transferee (section 2(3)-(5)).

3.28 The implied terms provided in section 2 are similar to those in section 12 of the 1979 Act which in turn, are similar to those in section 14 of Cap 26 in Hong Kong.

Conclusion

Same implied term for all types of supply of goods

3.29 As discussed, the statutory implied undertakings as to title for contracts of exchange in Australia (consumer transactions), contracts of exchange and contracts for work and materials in New Zealand (consumer transactions), and contracts for the transfer of property in goods in England and Wales (both consumer and non-consumer transactions), mainly follow the equivalent provisions in those countries' respective sale of goods legislation. Even for non-consumer contracts of exchange, and contracts for work and materials in Australia and New Zealand, the implied undertakings as to title are also no less than those in sale of goods contracts.

3.30 In addition, the common law position on implied undertakings as to title in contracts of barter, and contracts for work and materials in Hong Kong, are no less stringent than those implied in a contract of sale. This is in line with what has been stated in Chapter 1 that the same implied terms should be stipulated for all types of contracts for the supply of goods for the sake of consistency. Therefore, to achieve greater clarity, overall certainty and easier access to the law, it would be preferable to set out the implied terms as to title in the Recommended Legislation, along the lines of the implied undertakings as to title in section 14 of Cap 26.

Transfer only limited title to the transferee

3.31 If the intention of the parties is to transfer only limited title to the transferee, there should be implied warranties as to disclosure of charges or encumbrances which are known to the transferor but not known to the transferee before the agreement is made, and as to quiet possession of the transferee. This may be either the supplier's own limited title or that of a third party. This is in line with section 14 of Cap 26, the 1974 Act in Australia and the 1982 Act in England and Wales.

Certain provisions in Australia and New Zealand not applicable

3.32 Section 69(2) of the 1974 Act in Australia makes it clear that the existence of a floating charge over the assets of the corporation will not by itself breach the implied warranty as to freedom from encumbrance in

subsection (1)(c) unless and until the charge becomes fixed and crystallised. This provision protects a supplier from being accused of a "technical" breach of the implied warranty, since before a floating charge crystallises the chargor (supplier) can carry on its business as usual. There is no similar provision in section 2 of the 1982 Act in England and Wales, section 5 of the 1993 Act in New Zealand, nor in section 14 of Hong Kong's Cap 26. We do not therefore recommend a similar provision in Hong Kong for contracts for the supply of goods (other than sale).

3.33 Section 5(1)(c)(i) and (ii) of the 1993 Act in New Zealand provides that the right of undisturbed possession can be varied by following certain formalities, including the giving of an oral advice to a consumer (with receipt acknowledged in writing by the consumer) as to how his rights will be affected, and a written copy of the agreement or the part thereof providing for the variation. The advice must be sufficient to enable a reasonable consumer to understand the nature and effect of the variation. These formalities may not only create obstacles for business efficiency, but also be a breeding ground for litigation. We think a balance should be struck between providing flexibility to suppliers on the one hand, and maintaining business efficiency on the other. Furthermore, these formalities grant a new way for suppliers to limit their liabilities in respect of the implied undertakings as to quiet possession. There is no similar provision in section 2 of the 1982 Act in England and Wales and section 14 of Cap 26 in Hong Kong. In this connection, such detailed formalities are not recommended in Hong Kong for contracts for the supply of goods (other than sale).

Non-consumer transactions should also be covered

3.34 The 1982 Act in England and Wales covers both consumer and non-consumer transactions, while the 1974 Act in Australia and the 1993 Act in New Zealand cover only consumer transactions. However, the implied undertakings as to title in non-consumer contracts of exchange and contracts for work and materials in Australia and New Zealand at common law are also no less than those in sale of goods contracts. In any event, the Hong Kong common law position on implied undertakings as to title does not differentiate between consumer and non-consumer transactions. Cap 26 covers both consumer and non-consumer transactions. To achieve consistency with the sale of goods provisions, we therefore propose that non-consumers should also have the benefit of the protection of the implied undertakings as to title in the Recommended Legislation.

Recommendation 6

We recommend that implied terms about title, etc should be provided for in consumer and non-consumer contracts for transfer of property in goods similar to those in section 14 of Cap 26, namely:

(a)	**an implied condition that a transferor has a right to transfer the property and, in the case of an agreement to transfer, he will have such a right at the time when the property is to be transferred;**
(b)	**implied warranties that the goods are free and will remain free from charges or encumbrance not disclosed or known to the transferee before the contract is made; and the transferee will enjoy quiet possession, save as to encumbrances disclosed or known to the transferee; and**
(c)	**in the case of a transfer of limited title, implied warranties of disclosure of encumbrance to the transferee and of quiet possession by the transferee.**

Contracts of hire

Common law position in Hong Kong

3.35 A contract of hire of goods does not involve the transfer of title but of possession only. From the point of view of a hirer, he does not care who the actual owner[25] is so long as his possession of the goods will not be disturbed by the true owner or any person claiming through the owner, and he will not be sued by such person. Since whether the bailor is the owner of the goods is not relevant to a hiring of goods, an implied undertaking as to having the title to the goods will not usually be required. But other implied terms are relevant, such as having the right to hire out the goods and a hirer's entitlement to quiet possession during the period of hire.[26]

Australia

3.36 Section 69(1)(b) of the 1974 Act provides for an implied warranty of quiet possession in respect of contracts of hire:

> "*an implied warranty that the consumer will enjoy quiet possession of the goods except so far as it may lawfully be disturbed by the supplier or by another person who is entitled to the benefit of any charge or encumbrance disclosed or known to the consumer before the contract is made ..*."

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[25] It is also part of the law of bailment that an ordinary bailee is estopped from denying the title of his bailor. *Biddle v Bond* (1865) 6B & S225, 232; 122 ER, 1179, 1182, per Lord Blackburn. However, this does not apply to hire purchase as the provision of an option to acquire title gives the hirer the right to expect that the bailor has the title to transfer when he is required to transfer it. *Karflex Ltd v Poole* [1933] 2 KB 251.

[26] Such a term is implied in contracts of hire. *Lee v Atkinson and Brooks* (1609) Cro Jac 236; 79 ER 204.

3.37 The implied condition as to a right to sell in subsection (1)(a) only applies to sales, agreements to sell and hire purchase agreements. The implied warranty as to freedom from encumbrance in subsection (1)(c) only applies to the "*supply of goods under which the property is to pass or may pass*", while subsection (3) applies to transfers of limited title. Therefore, neither of these provisions applies to contracts of hire.

3.38 As the 1974 Act only applies to consumer transactions, non-consumer transactions are governed by common law. Regarding a bailor's right to hire out goods at common law, the position is less clear since there is no direct authority.[27] But there is a common law warranty giving a hirer a right to quiet possession for the period of hire subject to charges or encumbrances disclosed to the hirer before a contract is made.[28]

New Zealand

3.39 Section 5 of the 1993 Act expressly points out that only the guarantee as to the right of undisturbed possession applies to a contract of hire. Subsections (4) and (5) are as follows:

> "*(4) Nothing in subsection (1)(a) or (1)(b) of this section shall apply in any case where the goods are only hired or leased.*
>
> *(5) Where the goods are only hired or leased, the guarantee set out in subsection (1)(c) of this section shall confer a right to undisturbed possession of the goods only for the period of the hire or lease.*"

3.40 Subsection (1)(c) provides for a guarantee as to the right to undisturbed possession and subsection (5) provides that such guarantee is only for the period of hire.

3.41 As the 1993 Act only applies to consumer transactions, non-consumer transactions are governed by common law. In a contract of hire, there is an implied warranty that the hirer will enjoy quiet possession for the period of hire save as to charges or encumbrances disclosed or known to the hirer before the contract is made.[29] Such an implied term does not affect the right of the bailor to repossess the goods under an express or implied term of the contract.[30]

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27 Section 103 of the Goods Act 1958 (Vic) implies into a lease of goods a condition that the lessor has a right to hire the goods for the period of the hire.

28 *Lee v Atkinson* (1609) Yelv 172; 80 ER 114; *Warman v Southern Counties Car Finance Corp Ltd* [1949] 2 KB 576.

29 *Warman v Southern Counties Car Finance Corp Ltd* [1949] 2 KB 576.

30 *The Laws of New Zealand*, Vol 2 (Bailment), at para 58.

England and Wales

3.42 Section 7 of the 1982 Act provides for the implied term as to a right to transfer possession in respect of a contract of hire. It reads as follows:

> "*(1) In a contract for the hire of goods there is an implied condition on the part of the bailor that in the case of a bailment he has a right to transfer possession of the goods by way of hire for the period of the bailment and in the case of an agreement to bail he will have such a right at the time of the bailment.*
>
> *(2) In a contract for the hire of goods there is also an implied warranty that the bailee will enjoy quiet possession of the goods for the period of the bailment except so far as the possession may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance disclosed or known to the bailee before the contract is made.*
>
> *(3) The preceding provisions of this section do not affect the right of the bailor to repossess the goods under an express or implied term of the contract.*"

3.43 As a hirer is a bailee and he is only to obtain the possession, use and enjoyment of the goods but not the property of the goods, no term as to title is implied. There is however an implied *condition* that the bailor has a right to transfer possession of the goods by way of hire for the period of bailment, or in the case of an agreement to bail, he will have such a right at the time of the bailment (section 7(1)). Section 7(2) provides for a *warranty* that the bailee will enjoy quiet possession of the goods for the period of the bailment.

Conclusion

Implied term as to a right to hire out is desirable

3.44 As there is no transfer of title in a contract of hire, an implied term as to the title of a bailor is not needed. However, it would seem sensible to have an implied term that a bailor has a right to hire out the goods for the period of hire and, in an agreement to hire, that he will have that right at the time of hire. Otherwise, the hirer may be in breach of a third party's rights and run the risk of being sued.[31] There is no such an implied term in the 1974 Act in Australia, nor in the 1993 Act in New Zealand. Section 7(1) of the 1982 Act in England and Wales provides for such an implied term which, as discussed, is sensible. The existing common law position in Hong Kong is uncertain on

[31] For example, wrongful interference with goods.

this point. Clarification by providing for this implied term in the Recommended Legislation is therefore desirable.

Implied term as to quiet possession is desirable

3.45 There is an implied term of quiet possession in section 69(1)(b) of the 1974 Act in Australia, section 5(1)(c) in the 1993 Act in New Zealand and section 7(2) of the 1982 Act of England and Wales. Under the existing common law position of Hong Kong, a hirer is entitled to quiet possession during the period of hire. However, it would seem desirable to spell this out clearly in legislation. In both the 1974 Act in Australia and the 1982 Act in England and Wales, the right to quiet possession is subject to any charges or encumbrances disclosed or known to the hirer before the contract is made. Much more detailed formalities are stipulated in section 5(1)(c)(i) and (ii) of the 1993 Act in New Zealand. For the reasons discussed above, we suggest that such detailed formalities are neither necessary nor desirable. This right to quiet possession is to protect a hirer against being disturbed by the bailor or any person with a better right to possession of the goods, but not against being disturbed by thieves nor against lawful repossession according to the terms of the contract of hire.

Implied term as to freedom from encumbrance is not needed

3.46 The implied term as to freedom from encumbrance is expressly excluded from applying to a contract of hire by section 5(4) of the 1993 Act in New Zealand and impliedly excluded by section 69(1)(c) of the 1974 Act in Australia.[32] No provision is made in section 7 of the 1982 Act in England and Wales. Professor N E Palmer[33] is of the view that "*the hirer's security of title and possession are markedly inferior to those which govern transactions where property passes*". He then said, "*[the] inferiority concerns the lack of any statutory term specially implied into contracts of hire that the goods are free from any charge or incumbrance not disclosed or known to the hirer*".

3.47 It must be pointed that the implied term as to freedom from encumbrance is not strictly necessary for the protection of a hirer provided that a bailor has the right to hire out the goods and that the hirer enjoys quiet possession during the period of hire. Instead, such a term may create too much difficulty for a bailor or his business. For example, a bailor may need to charge the goods in question to finance his business or he may be in the process of acquiring the goods on hire purchase terms. In such situations, the inclusion of this implied term might be too onerous on the bailor. We therefore consider it best not to adopt the implied term as to freedom from encumbrance for contracts of hire in Hong Kong, even though there is such an implied warranty in section 14 of Cap 26.

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[32] It applies to "*a contract for the supply of goods under which the property is to pass or may pass to the consumer*".

[33] N E Palmer, "The Supply of Goods and Services Act 1982", (1983) 46 MLR 619 at p 624.

Non-consumer transactions should also be covered

3.48 The 1982 Act in England and Wales covers both consumer and non-consumer transactions while the 1974 Act in Australia and the 1993 Act in New Zealand cover only consumer transactions. The Hong Kong common law position on implied terms for contracts of hire does not differentiate between consumer and non-consumer transactions. Furthermore, Cap 26 also covers both consumer and non-consumer transactions. We accordingly take the view that non-consumer contracts of hire should also have the benefit of the protection of the implied terms.

Recommendation 7

We recommend that implied terms as to a right to transfer possession, etc should be provided for consumer and non-consumer contracts of hire, similar to those in section 14 of Cap 26, namely:

(a) an implied condition that a bailor has a right to hire out goods for the period of hire and, in the case of an agreement to hire, he will have such a right at the time of hire;

(b) an implied warranty that the hirer will have quiet possession of the goods for the period of hire save as to charges or encumbrances disclosed or known to the hirer before the contract of hire is made; and

(c) the above implied terms should not affect the right of the bailor to repossess the goods under the terms of the contract of hire.

Hire purchase agreements

Common law position in Hong Kong

3.49 In Hong Kong, hire purchase agreements are governed by common law. At common law, there is an implied condition that the person letting the goods has, or will have at the time of delivery of the goods, either the title to the goods or a right to dispose of them.[34] The common law rule that a bailee is estopped from disputing his bailor's title does not apply to hire purchase. This is because a hirer's option to purchase enables him to assume that the bailor has title or a right to dispose of the goods.[35]

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34 *Mercantile Union Guarantee Corporation, Ltd v Wheatley* [1938] 1 KB 490; *Karflex, Ltd v Poole* [1933] 2 KB 251.

35 *Mercantile Union Guarantee Corporation, Ltd v Wheatley* [1938] 1 KB 490; *Karflex, Ltd v Poole* [1933] 2 KB 251.

3.50 There is also an implied warranty that a bailor will allow a hirer to have peaceful possession of the goods during the period of hire.[36] This warranty will be broken if a hirer's quiet enjoyment is disturbed either by the bailor himself or by the lawful acts of third parties.

3.51 As to whether there is an implied warranty that the goods are or shall be free from charges or encumbrances in favour of a third party, there is no authority at common law.

Australia

Implied undertakings as to title, encumbrances and quiet possession

3.52 As "supply" is defined in section 4(1) of the 1974 Act to include "hire purchase", the implied undertakings as to title, encumbrances and quiet possession in section 69 also apply to hire purchase. According to section 69(1)(a), there is an implied condition, in the case of hire purchase agreements, that the supplier will have a right to sell the goods when property is to pass. There are also warranties as to quiet possession and freedom from encumbrance until the passing of property, other than the charges or encumbrances disclosed or known to the consumer before a contract is made (section 69(1)(b) and (c)).

3.53 According to section 69(3), in the case of a transfer of limited title, there are warranties as to quiet possession, and that disclosure has been made before the hire purchase agreement is made of any charges or encumbrances known to a bailor but not known to the bailee. Section 69(2) makes it clear that a floating charge over the assets of the corporation will not by itself be in breach of the implied warranty as to freedom from encumbrance in subsection (1)(c).

3.54 As the 1974 Act only applies to consumer transactions, non-consumer transactions are governed by the relevant state-legislated hire purchase acts. As discussed in Chapter 2 above, the States which retain their hire purchase acts are Queensland, Tasmania, Victoria and Western Australia. The Hire-Purchase Acts of these States imply into agreements conditions and warranties regarding title and the quality and fitness of the goods which are analogous to those implied in contracts of sale. There are implied warranties that a hirer will have and enjoy quiet possession of the goods, and that the goods are free from any charge or encumbrance in favour of any third party.[37] There is also an implied condition that the owner has the right to sell the goods at the time property is to pass to the hirer.[38]

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36 *Lee v Atkinson and Brooks* (1609), Cro Jac 236; *Lloyds and Scottish Finance, Ltd v Modern Cars and Caravans (Kingston), Ltd* [1966] 1 QB 764.

37 (QLD) Hire-Purchase Act 1959 s5(1); (TAS) Hire-Purchase Act 1959 s9(1); (VIC) Hire-Purchase Act 1959 s5(1); (WA) Hire-Purchase Act 1959 s5(1).

38 (QLD) Hire-Purchase Act 1959 s5(1); (TAS) Hire-Purchase Act 1959 s9(1); (VIC) Hire-Purchase Act 1959 s5(1); (WA) Hire-Purchase Act 1959 s5(1).

Concept of linked credit providers

3.55 Sections 73-73B of the 1974 Act govern the respective liability of dealers (referred to as "suppliers" in these provisions) of goods and credit providers in respect of defective goods. Section 73 provides for the liability of credit providers to consumers upon breaches of the statutory implied terms under sections 70 to 72 of the 1974 Act. It covers various types of financing, including hire purchase, continuing credit contracts and loan contracts.[39] Section 73 applies whether goods are supplied by a credit provider or dealer.[40]

(a) liability of, and defences available to, linked credit providers

3.56 A credit provider will only incur potential liability for defective goods where it is a "linked credit provider". A linked credit provider is defined in section 73(14).[41] Where a consumer enters into a contract with a linked credit provider for provision of credit, according to section 73(1), the linked credit provider and supplier are jointly and severally liable to the consumer for a breach of the statutory implied terms.[42] A credit provider who is not a linked credit provider will not be liable for a breach of these implied terms, but the consumer may recover the amount of the loss or damage from the supplier.[43]

3.57 Some defences[44] are available to a linked credit provider who would otherwise be liable under these provisions. A linked credit provider will not be liable to a consumer where the credit provider can prove that the credit was provided as the result of an approach by the consumer that was not induced by the supplier. It is also a defence for the credit provider to prove that:

(a) after due inquiry before becoming a linked credit provider of a supplier, the credit provider believed the supplier to be of good reputation as regards the latter's financial standing and business conduct; and

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39 "Continuing credit contract" and "loan contract" are defined in sections 73A and 73B respectively. In any event, they are not relevant to the present discussion.

40 Section 73(1)(a) and (b).

41 It is defined to mean a credit provider:

(a) who has a contract, arrangement or understanding with a dealer (supplier) concerning the supply to the supplier of goods; the business of the supplier; or the provision of credit;
(b) to whom a supplier, by arrangement with the credit provider, regularly refers persons wanting credit;
(c) who gives a supplier its credit application forms to be made available to prospective borrowers; or
(d) who has a contract, arrangement or understanding with a supplier under which documents concerning credit are available for signature by prospective borrowers at the supplier's premises.

42 Statutory implied terms under sections 70-72 as to correspondence with description, merchantable quality, fitness for purpose and supply by sample. It also covers breaches of the warranties implied by section 74 in contracts for services.

43 Section 73(2).

44 Section 73(3). It also expressly mentions "tied loan contract" and "tied continuing credit contract" which are not relevant to the present discussion.

(b) since becoming a linked credit provider, the credit provider has had no reason to suspect that the supplier might not be able to meet liability as it falls due.

3.58 Where a linked credit provider is unable to make out these defences (for example, where it has failed to make proper inquiries about a supplier), it will be jointly and severally liable with the supplier for damages recoverable by a consumer for breaching the implied terms.

(b) limitations on liability of linked credit providers and legal proceedings

3.59 Even where a linked credit provider is jointly and severally liable with a supplier, the liability of a linked credit provider to a consumer is limited to the amount financed under the credit contract, together with interest[45] and costs awarded by the court.[46] This is to limit the consequential losses which a consumer may recover from a linked credit provider.

3.60 Unless otherwise agreed, a supplier is liable to a linked credit provider for the loss suffered by the linked credit provider by virtue of these provisions, including legal costs in defending the proceedings.

3.61 A consumer must sue both the supplier and linked credit provider[47] but not just the linked credit provider alone unless:

(a) the supplier has been dissolved or wound up; or

(b) the court believes that it is not reasonably likely that judgment against the supplier would be satisfied.[48]

3.62 Where a judgment is entered against a linked credit provider and a supplier, the judgment cannot be enforced against the linked credit provider alone unless a written demand on the supplier has remained unsatisfied for 30 days.[49]

New Zealand

3.63 Under section 5(1)(a) of the 1993 Act, there is a guarantee that a supplier has a right to sell the goods which "*means a right to dispose of the ownership of the goods to the consumer at the time when that ownership is to pass*" (section 5(2)). There is also a guarantee that the goods are free from

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45 Assessed according to sections 73(11) & (12).

46 Section 73(7). According to section 73(9), the same applies to a counter-claim made against a linked credit provider under section 73(4).

47 Section 73(5). The same applies to a counter-claim made against a linked credit provider under section 73(4).

48 Section 73(6).

49 Section 73(8). According to section 73(9), the same applies to a counter-claim made against a linked credit provider under section 73(4).

undisclosed security which is defined in section 5(3) to mean "*any security that was neither disclosed to the consumer in writing before he or she agreed to the supply nor created by or with the express consent of the consumer*".

3.64 According to section 5(1)(c), a consumer has a right to undisturbed possession, subject to variations pursuant to the terms of the hire purchase agreement in question.

3.65 For non-consumer hire purchase agreements, section 11 of the Hire Purchase Act 1971 provides guarantees as to title.

England and Wales

3.66 The statutory implied terms for hire purchase agreements are provided in the 1973 Act. Section 8 of the 1973 Act provides for the implied terms as to title and reads as follows:

> "*(1) In every hire-purchase agreement, other than one to which subsection (2) below applies, there is –*
>
> *(a) an implied term on the part of the creditor that he will have a right to sell the goods at the time when the property is to pass; and*
>
> *(b) an implied term that –*
>
> *(i) the goods are free, and will remain free until the time when the property is to pass, from any charge or encumbrance not disclosed or known to the person to whom the goods are bailed or (in Scotland) hired before the agreement is made; and*
>
> *(ii) that person will enjoy quiet possession of the goods except so far as it may be disturbed by any person entitled to the benefit of any charge or encumbrance so disclosed or known.*
>
> *(2) In a hire-purchase agreement, in the case of which there appears from the agreement or is to be inferred from the circumstances of the agreement an intention that the creditor should transfer only such title as he or a third person may have, there is –*
>
> *(a) an implied term that all charges or encumbrances known to the creditor and not known to the person to whom the goods are bailed or hired have been*

disclosed to that person before the agreement is made; and

(b) an implied term that neither –

(i) the creditor; nor

(ii) in a case where the parties to the agreement intend that any title which may be transferred shall be only such title as a third person may have, that person; nor

(iii) anyone claiming through or under the creditor or that third person otherwise than under a charge or encumbrance disclosed or known to the person to whom the goods are bailed or hired, before the agreement is made;

will disturb the quiet possession of the person to whom the goods are bailed or hired.

(3) As regards England and Wales and Northern Ireland, the term implied by subsection (1)(a) above is a condition and the terms implied by subsections (1)(b), (2)(a) and (2)(b) above are warranties."

3.67 Under section 8(1)(a), there is an implied condition that a bailor will have a right to sell at the time when the property is to pass. There are also implied warranties as to freedom from encumbrance and quiet possession save as to charges or encumbrances disclosed or known to the hirer before the hire purchase agreement is made (section 8(1)(b)).

3.68 According to section 8(2), in the case of a transfer of limited title, there are warranties as to quiet possession, and disclosure, before the hire purchase agreement is made, of charges or encumbrances known to the bailor but not known to the bailee.

Conclusion

3.69 Similar implied terms as to title, quiet possession and freedom from encumbrance in hire purchase agreements, are found under the common law in Hong Kong, the 1974 Act in Australia, the 1993 Act in New Zealand and the 1973 Act in England and Wales. These implied terms are also similar to the implied undertakings as to title in section 14 of Cap 26.

Implied term as to a right to sell, quiet possession and freedom from encumbrance

3.70 In Hong Kong, with regard to implied undertakings as to title in respect of hire purchase agreements, there should be a statutory implied condition that a bailor will have a right to sell at the time when the property is to pass. "The time when the property is to pass" is more precise and accurate than "the time of delivery of the goods" as required at common law in Hong Kong. This is also in line with section 14 of Cap 26, the 1974 Act in Australia and the 1973 Act in England and Wales.

3.71 There should also be an implied warranty as to quiet possession save as to charges or encumbrances disclosed or known before a hire purchase agreement is made, similar to the warranties implied at common law in Hong Kong, in section 14 of Cap 26 and the relevant statutes of other jurisdictions as discussed above. As to freedom from encumbrance, there is no authority at common law. But to be in line with section 14 of Cap 26, it would seem preferable to have a statutory implied warranty that the goods will remain, until the property is to pass, free from encumbrances not disclosed or known to the hirer before the agreement is made. There are also such implied terms in the 1974 Act in Australia, the 1993 Act in New Zealand and the 1973 Act in England and Wales,

Transfer only limited title to the hirer

3.72 If the intention of the parties is to transfer only limited title to the hirer, there should also be implied warranties as to disclosure of charges or encumbrances known to the bailor but not known to the hirer before the agreement is made, and as to quiet possession of the hirer. This may be either his own limited title or that of a third party. This is in line with section 14 of Cap 26. There are also such implied terms in the Australian and English legislation.

Non-consumer transaction should be covered

3.73 As discussed under the headings "Contracts for transfer of property in goods" and "Contracts of hire" above, the statutory implied terms as to title should apply to both consumer and non-consumer hire purchase agreements. There is no need to have a provision similar to that in section 69(2) of the Australian 1974 Act concerning floating charges.

Concept of linked credit providers not appropriate for Hong Kong

3.74 There are two main features of section 73 of the 1974 Act. First, it makes suppliers (dealers) principally responsible for breaches of the implied terms. Secondly, it limits liability of credit providers in various ways. Credit providers will only be liable when they are linked credit providers as defined. They have statutory defences, and their liability is limited to the amount financed and legal costs. They can claim reimbursement from suppliers

(dealers) for the loss suffered. Even in the legal proceedings, they are put in a much better position than that of suppliers.

(a) liability of credit providers to hirers

3.75 The most common way in which hire purchase is practised in Hong Kong is in the form of a triangular transaction.[50] Dealers sell goods outright to credit providers who, as owners, hire out the goods to customers under hire purchase agreements. Therefore, hire purchase agreements are made between hirers and credit providers (not dealers) who are suppliers of the goods. As discussed in this Paper, in Hong Kong credit providers are liable to customers for breaches of the terms implied under the existing common law since they are usually suppliers of the goods. Credit-providers appear to have no problem with the existing common law position.[51]

(b) liability of dealers to hirers

3.76 Where hire purchase agreements are made between dealers and hirers, the position as regards the liability of dealers to hirers is the same as for hire purchase agreements between hirers and credit providers. Where dealers sell goods to credit providers who enter into hire purchase agreements with hirers, under existing common law the dealers may still incur contractual[52] and tortious liability (for fraud and negligence)[53] to the hirers if the goods have defects.

3.77 Nowadays, goods commonly acquired by way of hire purchase[54] are cars and office equipment (eg photocopying machines). Even though dealers are not parties to hire purchase agreements, because of market forces, they usually undertake to repair defective goods. The present situation should not therefore raise too much concern.

3.78 As discussed above, under section 73, dealers (referred to as "suppliers") are made principally liable to hirers, and the liability of credit providers is limited in various ways. Unless there is valid reason to make dealers principally liable to hirers or to limit liability of credit providers,

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50 This is according to Mr K M Li and Mr Steve Page in telephone conversations between the Secretary of the Sub-committee and them both on 28 Oct 1999. Mr Li, Deputy Chief Executive of the Consumer Council, and Mr Page, Deputy Managing Director of Wayfoong Finance Ltd, both are members of the Sub-committee.

51 Mr Yeates, Deputy Managing Director of Wayfoong Finance Ltd, a member of the Sub-committee until 3 June 1999, has mentioned that he is concerned that the position of credit-providers will not be weakened by the Recommended Legislation.

52 Basically, hirers could have no contractual claims against dealers since the latter are not parties to hire purchase agreements. However, where a dealer has made an express warranty about the goods, the court may regard this as giving rise a collateral contract. If the warranty is broken, the dealer will be liable. *Andrews v Hopkinson* [1957] 1 QB 229. See also R M Goode, *Hire Purchase Law and Practice*, 2nd Ed, 1970, at p 638-640.

53 Where a dealer acts fraudulently or makes untrue statements knowingly or regardless whether they are true or not, he may be liable in tort of deceit. Where a dealer supplies defective goods negligently and the hirer suffers loss, the dealer may be liable in tort of negligence.

54 This is according to Mr K M Li in a telephone conversation between Mr Li and the Secretary of the Sub-committee on 28 Oct 1999.

provisions similar to section 73 should not be included in the Recommended Legislation.

Recommendation 8

We recommend that implied terms about title, etc similar to those in section 14 of Cap 26 should be provided for consumer and non-consumer hire purchase agreements, namely:

(a) an implied condition that a bailor will have a right to sell the goods when the property is to pass;

(b) implied warranties that the goods are free and will remain free from charges or encumbrances not disclosed or known to the hirer before the agreement is made; and the hirer will enjoy quiet possession, save as to charges or encumbrances disclosed or known to the hirer; and

(c) in the case of a transfer of limited title, implied warranties of disclosure to the hirer of charges or encumbrances known to the bailor but not the hirer, and of quiet possession by the hirer.

Chapter 4

Implied terms to be included in the Recommended Legislation – correspondence with description

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Overview

4.1 In this chapter, we first examine the implied term as to correspondence with description in section 15 of the Sale of Goods Ordinance (Cap 26). Then, in respect of this implied term, we examine the three types of contracts for supply of goods recommended in Chapter 2, namely contracts for transfer of property in goods, contracts of hire and hire purchase agreements.

4.2 For each of these three types of contracts, we first examine the common law position in Hong Kong and then the positions in Australia, New Zealand and England and Wales. We also examine the relevant comments of academics and overseas law reform bodies.

4.3 We then make recommendations for each of the three types of contracts as follows:

(a) contracts for transfer of property in goods – **Recommendation 9**;
(b) contracts of hire – **Recommendation 10**;
(c) hire purchase agreements – **Recommendation 11**.

Correspondence with description under Cap 26

4.4 The undertakings as to correspondence with description are set out in section 15 of Cap 26 which reads as follows:

> *"(1) Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description; and if the sale is by sample, as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.*

(2) A sale of goods shall not be prevented from being a sale by description by reason only that, being exposed for sale or hire, they are selected by the buyer."

4.5 Where there is a contract for the sale of goods by description, there is an implied *condition*, under section 15, that the goods will correspond with the description. If the sale is by sample and by description, the bulk of the goods must correspond with both the sample and the description. A sale may be a sale "by description" even if the goods are exposed for sale or hire and are selected by a buyer.[1]

Contracts for the transfer of property in goods

Common law position in Hong Kong

4.6 As discussed in Chapter 3 on "Implied terms about title", in a contract of barter, the terms to be implied at common law, would be similar to those implied for a contract of sale by Cap 26 in its original version. In addition, terms implied in a contract for work and materials are, so far as the materials are concerned, no less stringent than those implied in a contract of sale.

4.7 Terms as to correspondence with description were implied in contracts of sale at common law before the enactment of Cap 26.[2] Applying the principle in the above paragraph, similar terms should be implied in contracts of barter and contracts for work and materials and in general, for contracts for the transfer of property in goods. However, setting out the rules in legislation would be clearer, more certain and would provide easier access to the law.

Australia

4.8 An implied term as to correspondence with description is provided in section 70 of the 1974 Act as follows:

"(1) Where there is a contract for the supply (otherwise than by way of sale by auction) by a corporation in the course of a business of goods to a consumer by description, there is an implied condition that the goods will correspond with the description, and, if the supply is by reference to a sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

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1 S15(2). Similar provision was also added to the 1979 Act by the 1973 Act in England. The amendment was made to remove any doubt as to whether a sale in a self-service store could constitute a sale by description; the provision makes it clear that it can.

2 *Randall v Newson* [1877] 2 QBD 102, at p 109, per Brett J A.

(2) A supply of goods is not prevented from being a supply by description for the purposes of subsection (1) by reason only that, being exposed for sale or hire, they are selected by the consumer."

4.9 This implied term applies to all kinds of supply of goods as defined in section 4 which includes barter but not contracts for work and materials.[3] There is an implied condition that goods will correspond with description. If the supply is by reference to a sample as well as by description, the bulk of the goods must correspond with both the sample and the description. A supply of goods is also by description even if the goods are exposed for sale or hire and selected by a consumer. This implied condition only applies where the goods are supplied "in the course of a business".[4]

4.10 As the 1974 Act only applies to consumer transactions, the implied term as to correspondence with description applies to consumer transactions only. Non-consumer supply of goods is governed by common law. There is also no direct authority on barter concerning this. However, the Australian court may follow the views of Blackburn[5] and Chalmers[6] that the common law obligations of a seller apply to a supplier in contracts of barter. No direct authority can be found in respect of correspondence with description in contracts for work and materials. However, there are implied terms as to fitness for purpose and good quality.[7] Therefore, the Australian courts would probably also imply a term as to correspondence with description similar to that implied for a sale of goods contract.

New Zealand

4.11 Section 9 of the 1993 Act provides for the implied term as to correspondence with description and reads as follows:

"(1) Subject to section 41 of this Act, where goods are supplied by description to a consumer, there is a guarantee that the goods correspond with the description.

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3 As mentioned in Chapter 2, section 74 separately provides for some implied terms for contracts for work and materials. But it does not provide for the implied term as to correspondence with description. See Chapter 5 for the text of section 74.

4 According to the *Halsbury's Laws of Australia*, "*English authorities, concerned with analogous legislation, suggest that this expression conveys the concept of some degree of regularity, and the sporadic sale by a corporation of superseded items of capital equipment does not meet this test*: *Davies v Sumner* [1984] 1 WLR 1301"; see *Halsbury's Laws of Australia*, vol 5 [100-650] note 1.

5 Lord Blackburn, *Blackburn's Contract of Sale,* 3rd Ed, 1910, at p ix.

6 Michael Mark, *Chalmers Sale of Goods,* 18th Ed, 1981, at p 82-83.

7 *Halsbury's Laws of Australia*, para 40-415, note 1; para 110-2165, notes 8-9. *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46; *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454.

(2) A supply of goods is not prevented from being a supply by description by reason only that, being exposed for sale or hire, they are selected by a consumer.

(3) If the goods are supplied by reference to a sample or demonstration model as well as by description, the guarantees in this section and in section 10 of this Act will both apply.

(4) Where the goods fail to comply with the guarantee in this section -

(a) Part II of this Act gives the consumer a right of redress against the supplier; and

(b) Part III of this Act may give the consumer a right of redress against the manufacturer."

4.12 This implied term applies to all kinds of supply of goods as defined in section 2 and therefore, it applies to barter, and contracts for work and materials by virtue of section 15. The implied guarantee is that the goods will correspond with description. If the supply is by reference to a sample as well as by description, the bulk of the goods must correspond with both the sample and the description. A supply of goods may be by description even if the goods are exposed for sale or hire and selected by a consumer. This implied guarantee only applies where the goods are supplied in trade (section 41), which is defined in section 2(1).

4.13 As the 1993 Act only applies to consumer transactions, non-consumer contracts for transfer of property in goods (such as barter and contracts for work and materials) are governed by common law. The law relating to barter is undeveloped in New Zealand. The court "*seems inclined to deal with such contracts as if they were analogous to contracts of sale*".[8] As to contracts for work and materials, there is no direct authority in respect of the implied term relating to correspondence with description, but terms as to fitness for purpose and good quality are implied for such contracts.[9] Therefore, the New Zealand court may imply a term as to correspondence with description similar to that implied for a sale of goods contract.

England and Wales

4.14 The implied term as to correspondence with description is provided in section 3 of the 1982 Act which reads as follows:

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8 *The Laws of New Zealand*, Vol 23, at para 54 and note 7.

9 *The Laws of New Zealand*, Vol 2, at para 74. *Batchelor's Pram House Ltd v Mckenzie Brothers Electrical Ltd* [1962] NZLR 545 at p 547.

"(1) This section applies where, under a contract for the transfer of goods, the transferor transfers or agrees to transfer the property in the goods by description.

(2) In such a case there is an implied condition that the goods will correspond with the description.

(3) If the transferor transfers or agrees to transfer the property in the goods by sample as well as by description it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.

(4) A contract is not prevented from falling within subsection (1) above by reason only that, being exposed for supply, the goods are selected by the transferee."

4.15 As in Australia and New Zealand, there is an implied condition that the goods will correspond with the description. If the supply is by reference to a sample as well as by description, the bulk of the goods must correspond with both the sample and the description. A supply of goods is also by description even if the goods are exposed for supply and selected by a transferee. The 1982 Act applies to both consumer and non-consumer transactions.

Conclusion

4.16 From the above discussion, it is clear that in other jurisdictions, there are also implied terms as to correspondence to description for contracts of barter and contracts for work and materials in particular, and contracts for transfer of property in goods in general. The provisions in those jurisdictions are similar to the corresponding section 15 of Cap 26 which should provide a blueprint for other types of contracts for the supply of goods. Like Cap 26, the proposed implied term should apply to both consumers and non-consumers. In section 15(2) of Cap 26, "being exposed for sale or hire" is used while in the corresponding subsection of the 1982 Act of England and Wales, "being exposed for supply" is used. After comparing the two, it is preferable to adopt "being exposed for supply" to allow for the possibility of goods being exposed with a view to other types of transactions.

Recommendation 9

We recommend that provisions as to correspondence with description similar to those in section 15 of Cap 26 should be provided for consumer and non-consumer contracts for transfer of property in goods, namely:

(a)	**an implied condition that the goods correspond with the description if the transfer is by description;**
(b)	**a provision that if the transfer is both by description and by sample, the bulk of the goods should correspond with both the description and the sample; and**
(c)	**a provision that it is still a supply by description even if the goods are exposed for supply and selected by a transferee.**

Contracts of hire

Common law position in Hong Kong

4.17 Where goods are supplied under a contract of hire by description, it should seem desirable to have an implied term that the goods correspond with the description. There is not much case law to support this point but there is some support for the proposition that there is an implied term as to correspondence with description.[10] Therefore, the term implied at common law concerning correspondence to description should substantially be the same as that implied by Cap 26 for a contract of sale.

Australia

4.18 For consumer contracts of hire, an implied condition as to correspondence with description is provided in section 70 of the 1974 Act, since "supply" is defined in section 4 to include "hire". Therefore, the discussion above under the heading "Contracts for transfer of property in goods" also applies to contracts of hire.

4.19 For non-consumer contracts of hire, in Victoria where a bailor bails the goods by description, there is an implied condition that the goods will correspond with the description.[11]

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10 See *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584, a hire-purchase case, per Pearson L J at p 595, Upjohn LJ at p 597 and Ormerod L J at p 600; *Reardon Smith Line Ltd v YngvarHansen-Tangen* [1976] 1 WLR 989, per Viscount Dilhorne, at p 1000.
In England and Wales, on consultation, there was general support for the view of the Law Commission that the terms implied at common law as regards correspondence to description should substantially be the same as the terms implied by statute in contracts for the supply of goods by sale. (Law Com No 95, at para 86)

11 (Vic) Goods Act 1958 s104. However, in the Northern Territory, South Australia and Western Australia, such an implied condition is implied into consumer contracts only: (NT) Consumer Affairs and Fair Trading Act 1990 s63; (SA) Consumer Transactions Act 1972 s8(3); (WA) Fair Trading Act 1987 s37. There is no equivalent provision in other jurisdictions.

New Zealand

4.20 Section 2 of the 1993 Act defines "supply" to include "hire". The implied condition as to correspondence with description provided in section 9 therefore also applies to consumer contracts of hire. Therefore, the discussion above under the heading "Contracts for transfer of property in goods" also applies to contracts of hire.

4.21 For non-consumer contracts of hire, there is no direct case law on this point even though there is some support for the imposition of an implied warranty as to a hirer's quiet possession for the period of hire.[12]

England and Wales

4.22 Section 8 of the 1982 Act provides for an implied term as to correspondence with description and reads as follows:

> *"(1) This section applies where, under a contract for the hire of goods, the bailor bails or agrees to bail the goods by description.*
>
> *(2) In such a case there is an implied condition that the goods will correspond with the description.*
>
> *(3) If under the contract the bailor bails or agrees to bail the goods by reference to a sample as well as a description it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.*
>
> *(4) A contract is not prevented from falling within subsection (1) above by reason only that, being exposed for supply, the goods are selected by the bailee."*

4.23 As in contracts for the transfer of property in goods, there is an implied condition that the goods will correspond with the description in both consumer and non-consumer contracts of hire. If the supply is by reference to a sample as well as by description, the bulk of the goods must correspond with both the sample and the description. A supply of goods is also by description even if the goods are exposed for supply and selected by a hirer.

Conclusion

4.24 In Australia, New Zealand and England and Wales, there are also implied terms as to correspondence to description for contracts of hire and their provisions are similar to the corresponding section 15 of Cap 26 in

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[12] See *The Laws of New Zealand*, "Bailment", at para 58.

Hong Kong. We recommend including a similar implied term for contracts of hire in the Recommended Legislation. Like Cap 26, the proposed implied term should apply to both consumers and non-consumers. As discussed under the heading of "Contracts for transfer of property in goods", it would be preferable to adopt "being exposed for supply" instead of "being exposed for sale or hire" to allow for the possibility of goods being exposed with a view to other types of transactions.

Recommendation 10

We recommend that provisions as to correspondence with description similar to those in section 15 of Cap 26 should be provided for consumer and non-consumer contracts of hire, namely:

(a) an implied condition that the goods correspond with the description if the hire is by description;

(b) a provision that if the hire is both by description and by sample, the bulk of the goods should correspond with both the description and the sample; and

(c) a provision that it is still a supply by description even if the goods are exposed for supply and selected by a hirer.

Hire purchase agreements

Common law position in Hong Kong

4.25 At common law, there is an implied condition that goods let on hire purchase correspond with their description.[13] Where the goods are let both by description and sample, Professor Goode is of the view that it is reasonable to suppose that the bulk must correspond with both the description and sample.[14] The goods must correspond with the description in every particular. Otherwise, a hirer is entitled to reject the goods even though the discrepancy is small.[15]

Australia

4.26 For consumer hire purchase agreements, an implied condition as to correspondence with description is provided in section 70 of the 1974

13 *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584.
14 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 219.
15 *Arcos Ltd v E A Ronaasen & Son* [1933] AC 470.

Act, since "supply" is defined in section 4 to include "hire purchase". Therefore, the discussion above under the heading "Contracts for transfer of property in goods" also applies to hire purchase agreements.

4.27 For non-consumer hire purchase agreements, the position is less clear since there is no statutory implied term in the relevant Hire-Purchase Acts.[16] It is possible that the Australia court may follow the common law authority that goods let on hire purchase should correspond with their description.[17]

New Zealand

4.28 Section 2 of the 1993 Act defines "supply" to include "hire purchase". The implied condition as to correspondence with description provided in section 9 should therefore apply to consumer hire purchase agreements. Therefore, the discussion above under the heading "Contracts for transfer of property in goods" also applies to hire purchase agreements.

4.29 For non-consumer hire purchase agreements, section 14(2) of the Hire Purchase Act 1971 provides a similar guarantee as to correspondence with description.

England and Wales

4.30 Section 9 of the 1973 Act provides for an implied term as to correspondence with description. It reads as follows:

> *"(1) Where under a hire-purchase agreement goods are bailed or (in Scotland) hired by description, there is an implied term that the goods will correspond with the description, and if under the agreement the goods are bailed or hired by reference to a sample as well as a description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.*
>
> *(1A) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition.*
>
> *(2) Goods shall not be prevented from being bailed or hired by description by reason only that, being exposed for sale, bailment or hire, they are selected by the person to whom they are bailed or hired."*

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16 (QLD) Hire-Purchase Act 1959; (TAS) Hire-Purchase Act 1959; (VIC) Hire-Purchase Act 1959; (WA) Hire-Purchase Act 1959.

17 *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584.

4.31 There is an implied condition that goods correspond with their description in both consumer and non-consumer hire purchase agreements. If the supply is by reference to a sample as well as by description, the bulk of the goods must correspond with both the sample and the description. A bailment or hire of goods is also by description even if the goods are exposed for sale, bailment or hire and selected by a bailee or hirer.

Conclusion

4.32 In Australia, New Zealand and England and Wales, implied terms as to correspondence to description apply to hire purchase agreements, similar to those in section 15 of Cap 26 in Hong Kong. We recommend including a similar implied term for hire purchase agreements in the Recommended Legislation. Like Cap 26, the proposed implied term should apply to both consumers and non-consumers. As discussed under the heading of "Contracts for transfer of property in goods", it would be preferable to adopt "being exposed for supply" instead of "being exposed for sale or hire" to allow for the possibility of goods being exposed with a view to other types of transactions.

Recommendation 11

We recommend that provisions as to correspondence with description similar to those in section 15 of Cap 26 should be provided for both consumer and non-consumer hire purchase agreements, namely:

(a) an implied condition that the goods correspond with the description if the bailment is by description;

(b) a provision that if the bailment is both by description and by sample, the bulk of the goods should correspond with both the description and the sample; and

(c) a provision that it is still a supply by description even if the goods are exposed for supply and selected by a bailee.

Chapter 5

Implied terms to be included in the Recommended Legislation – implied terms about quality or fitness

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Overview

5.1 In this chapter, we first examine the implied undertakings as to quality or fitness in section 16 of the Sale of Goods Ordinance (Cap 26). Then, in respect of these implied terms, we examine the three types of contracts for supply of goods recommended in Chapter 2, namely contracts for transfer of property in goods, contracts of hire and hire purchase agreements.

5.2 For each of these three types of contracts, we first examine the common law position in Hong Kong and then the positions in Australia, New Zealand and England and Wales. We also examine the relevant comments of academics and overseas law reform bodies.

5.3 For each of these three types of contracts, we discuss the similarities and differences of the provisions in section 16 of Cap 26 with the relevant provisions of other jurisdictions. As to the differences, we discuss the following issues in particular:

(a) the reasonable man test should be adopted for "quality";
(b) the list of aspects of "quality" should be non-exhaustive;
(c) in the list of aspects of "quality", goods are required to be fit for all their common purposes;
(d) the term "satisfactory quality" should replace "merchantable quality";
(e) "state or condition" should be put together with the list of aspects of "quality" in the same sub-section;
(f) the concept of "antecedent negotiation" in section 16(6) of Cap 26 should be followed.

5.4 For contracts of hire, we discuss the following issues in particular:

(a) the liability of a bailor should be strict;
(b) there should be two obligations: quality and fitness for purpose;
(c) the implied terms as to quality and fitness for purpose should be conditions;
(d) a bailor should not be liable for defects made known to a hirer, or where the hirer did not make known the required purpose or did not rely on the bailor's skill or judgment.

5.5 We then make recommendations for each of the three types of contracts as follows:

(a) contracts for transfer of property in goods – **Recommendation 12**;
(b) contracts of hire – **Recommendation 13**;
(c) hire purchase agreements – **Recommendation 14**.

Implied undertakings as to quality or fitness under Cap 26

5.6 Section 16 of Cap 26 deals with the undertakings of a seller as to the quality or fitness of goods sold:

> *"(1) This section provides for the circumstances in which, and the extent to which, there is any implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied under a contract of sale.*
>
> *(2) Where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of merchantable quality, except that there is no such condition –*
>
> *(a) as regards defects specifically drawn to the buyer's attention before the contract is made; or*
>
> *(b) if the buyer examines the goods before the contract is made, as regards defects which that examination ought to reveal; or*
>
> *(c) if the contract is a contract for sale by sample, as regards defects which would have been apparent on a reasonable examination of the sample.*
>
> *(3) Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known to the seller any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied under the contract are reasonably fit for*

that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the seller's skill or judgment.

(4) An implied condition or warranty as to quality or fitness for a particular purpose may be annexed to a contract of sale by usage.

(5) Subsections (1), (2), (3) and (4) apply to a sale by a person who in the course of a business is acting as agent for another as they apply to a sale by a principal in the course of a business, except where that other is not selling in the course of a business and either the buyer knows that fact or reasonable steps are taken to bring it to the notice of the buyer before the contract is made.

(6) In the application of subsection (3) to an agreement for the sale of goods under which the purchase price or part of it is payable by instalments any reference to the seller shall include a reference to the person by whom any antecedent negotiations are conducted.

(7) In subsection (6) 'antecedent negotiations' (事先商議) means any negotiations or arrangements with the buyer whereby he was induced to make the agreement or which otherwise promoted the transaction to which the agreement relates.

(8) Except as provided by this section and section 17, and subject to the provisions of any other enactment, there is no implied condition or warranty as to the quality or fitness for any particular purpose of goods supplied under a contract of sale."

"In the course of a business"

5.7 A distinguishing feature of this section is that it relates to selling "in the course of a business". For the purpose of Cap 26, a "business" includes a profession and the activities of a public body, a public authority, or a board, commission, committee or other body appointed by the Chief Executive or Government.[1] In contrast, with sections 14, 15 and 17 which relate to undertakings as to title and as to sale by description or sample, the obligations of a seller arise whether the sale is in the course of a business or is a "private" sale.

[1] S2(1).

Implied term as to merchantable quality

5.8 Section 16(2) of Cap 26 provides that where goods are sold in the course of a business, there is an implied *condition* that the goods supplied under the contract are of merchantable quality. There is no such *condition* as regards defects which have been specifically drawn to the attention of the buyer before the contract is made or which ought to have been revealed or apparent on examination of the goods or sample. The term "merchantable quality" is defined in section 2(5). The criteria for determining whether particular goods are of merchantable quality are fitness for the purpose(s) for which goods of that kind are commonly bought, standard of appearance and finish, freedom from defects, safety and durability. These criteria are measured in light of any description applied to the goods and the price (if relevant).[2]

Implied term as to fitness for purpose

5.9 Section 16(3) implies into a contract of sale in the course of a business of a seller a *condition* that the goods supplied under the contract are reasonably fit for any particular purpose for which the goods are being bought, if that purpose has been made known to the seller by the buyer expressly or by implication. This applies whether or not the purpose is a purpose for which goods of that kind are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the seller's skill or judgment.

Contracts for the transfer of property in goods

Common law position in Hong Kong

5.10 As discussed in Chapter 3 on "Implied terms about title", the terms to be implied into contracts of barter at common law would be similar to those implied for contracts of sale by Cap 26 in its original version.

5.11 Also as discussed in Chapter 3, in the Court of Appeal, du Parcq L J said,

> *"... I think that the true view is that a person contracting to do work and supply materials warrants that the materials which he*

[2] Section 2(5) was replaced in October 1994 by the Sale of Goods (Amendment) Ordinance 1994. Paragraphs (b), (c), (d) and (e) of the new section 2(5) are new and follow to a large extent the wording in paragraphs (b), (c), (d) and (e) of section 14 (2B) of the English 1979 Act, as amended by the Sale and Supply of Goods Act 1994. Section 14(2B) refers to goods being of "satisfactory quality" which replaces the previous term of "merchantable quality". It will take some time for case law to develop in England on the meaning of "satisfactory quality". How the case-law on the meaning of "merchantable quality" will develop in Hong Kong remains to be seen since the term "merchantable quality" has been retained but the term now includes concepts incorporated under the term "satisfactory quality", a new term the meaning of which has yet to develop in England.

uses will be of good quality and reasonably fit for the purpose for which he is using them, unless the circumstances of the contract are such as to exclude any such warranty".[3]

5.12 From both *Dodd and Dodd v Wilson and McWilliam*[4] and *Young & Marten Ltd v McManus Childs Ltd,*[5] it is clear that the terms implied in a contract for work and materials are, so far as the materials are concerned, no less stringent than those implied in a contract of sale.

5.13 Therefore, at common law, terms as to quality and fitness for purpose similar to those implied for contracts of sale would be implied for contracts for the transfer of property in goods generally, including contracts of barter and contracts for work and materials.

Australia

5.14 The implied terms as to quality and fitness provided in section 71 of the 1974 Act read as follows:

> *"(1) Where a corporation supplies (otherwise than by way of sale by auction) goods to a consumer in the course of a business, there is an implied condition that the goods supplied under the contract for the supply of the goods are of merchantable quality, except that there is no such condition by virtue only of this section:*
>
> *(a) as regards defects specifically drawn to the consumer's attention before the contract is made; or*
>
> *(b) if the consumer examines the goods before the contract is made, as regards defects which that examination ought to reveal.*
>
> *(2) Where a corporation supplies (otherwise than by way of sale by auction) goods to a consumer in the course of a business and the consumer, expressly or by implication, makes known to the corporation or to the person by whom any antecedent negotiations are conducted any particular purpose for which the goods are being acquired, there is an implied condition that the goods supplied under the contract for the supply of the goods are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the consumer does not rely, or that it is unreasonable for him or her to*

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3 *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46.
4 [1946] 2 All ER 691.
5 [1969] 1 AC 454.

rely, on the skill or judgment of the corporation or of that person.

(3) Subsections (1) and (2) apply to a contract for the supply of goods made by a person who in the course of a business is acting as agent for a corporation as they apply to a contract for the supply of goods made by a corporation in the course of a business, except where that corporation is not supplying in the course of a business and either the consumer knows that fact or reasonable steps are taken to bring it to the notice of the consumer before the contract is made."

Implied condition as to merchantable quality

5.15 This implied term applies to all kinds of supply of goods as defined in section 4 which includes barter but not contracts for work and materials. Section 71 provides for an implied condition as to merchantable quality of the goods unless, before the contract, the consumer's attention has been drawn to the defects, or the consumer has examined the goods and that examination should have revealed the defects. According to section 66(1), a reference to the quality of goods includes the state or condition of the goods. Section 66(2) further provides that goods are of merchantable quality if they are as fit for the purpose(s) for which goods of that kind are commonly bought as it is reasonable to expect, having regard to the description, price (if relevant) and other relevant factors.

Implied condition as to fitness for purpose

5.16 Section 71(2) provides for the implied condition as to fitness for purpose when a consumer, expressly or by implication, makes known to the supplier (the corporation), or to the person by whom any antecedent negotiation are conducted, any particular purpose for which the goods are acquired. There is no such condition where a consumer does not rely, or it is unreasonable for him to rely, on the skill or judgment of the supplier or that person. An antecedent negotiation is defined to mean any negotiation or arrangement conducted or made with a consumer by another person in the course of a business carried on by the other person by which the consumer was induced to make the contract or which otherwise promoted the transaction.

Agent for the supplier

5.17 Section 71(3) provides that this section also applies to the supply of goods by a person who, in the course of a business, acts as agent for a corporation (the supplier). There is an exception where the corporation is not supplying in the course of a business and either the consumer knows it or reasonable steps are taken to alert the consumer before the contract. This

implied condition only applies where the goods are supplied "in the course of a business".[6]

Section 74 provides for contracts for work and materials

5.18 The implied terms as to quality and fitness provided for contracts for work and materials in section 74 are as follows:

> *"(1) In every contract for the supply by a corporation in the course of a business of services to a consumer there is an implied warranty that the services will be rendered with due care and skill and that any materials supplied in connexion with those services will be reasonably fit for the purpose for which they are supplied.*
>
> *(2) Where a corporation supplies services (other than services of a professional nature provided by a qualified architect or engineer) to a consumer in the course of a business and the consumer, expressly or by implication, makes known to the corporation any particular purpose for which the services are required or the result that he or she desires the services to achieve, there is an implied warranty that the services supplied under the contract for the supply of the services and any materials supplied in connexion with those services will be reasonably fit for that purpose or are of such a nature and quality that they might reasonably be expected to achieve that result, except where the circumstances show that the consumer does not rely, or that it is unreasonable for him or her to rely, on the corporation's skill or judgment.*
>
> *(3) A reference in this section to services does not include a reference to services that are, or are to be, provided, granted or conferred under:*
>
> *(a) a contract for or in relation to the transportation or storage of goods for the purposes of a business, trade, profession or occupation carried on or engaged in by the person for whom the goods are transported or stored; or*
>
> *(b) a contract of insurance*."

5.19 Section 74(1) implies a warranty that any materials supplied in connection with services shall be reasonably fit for the purpose for which they

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[6] According to the *Halsbury's Laws of Australia*, "*English authorities, concerned with analogous legislation, suggest that this expression conveys the concept of some degree of regularity, and the sporadic sale by a corporation of superseded items of capital equipment does not meet this test: Davies v Sumner* [1984] 3 All ER 831"; see *Halsbury's Laws of Australia*, vol 5 [100-650] note 1.

are supplied. Section 74(2) implies a warranty that where any particular purpose is made known, the materials supplied shall be fit for that particular purpose, except where a consumer does not, or it is unreasonable for him to, rely on the skill or judgment of the supplier.

5.20 Section 74(1) has been criticised for imposing a different set of obligations regarding the materials supplied, depending on whether a supplier supplies just the materials or the materials together with services.[7] The Law Commission of England and Wales has made similar criticisms.[8] The obligation of a supplier under section 74(1) is unqualified and he is liable even where a customer does not rely on the supplier's skill or judgment or does so unreasonably. On the contrary, section 71(1) provides that a supplier's obligations are qualified by any defects specifically drawn to a consumer's attention or defects which ought to have been revealed by an examination. Section 74(1) appears to impose much stricter obligations on a supplier than section 71(1) does, as far as the materials are concerned.

5.21 Section 74(2), dealing with any particular purpose drawn to a supplier's attention, contains the same qualification regarding reliance on the supplier's skill or judgment as that contained in section 71(2). However, terms implied under section 74 are warranties, as opposed to conditions implied under section 71.

5.22 As discussed in Chapter 1, it is preferable that terms implied for each type of supply of goods should be consistent as far as possible. Therefore, terms implied in the Recommended Legislation concerning the materials supplied under contracts for work and materials should be consistent with other types of supply of goods.

Non-consumer transactions

5.23 As the 1974 Act only applies to consumer transactions, the implied conditions as to quality and fitness apply to consumer transactions only. Non-consumer transactions of supply of goods are governed by common law. Although there is no direct authority as to the implied terms in barter, the Australian court is likely to follow the view that the common law obligations of a seller apply to the supplier in a contract of barter. Terms as to fitness for purpose and good quality are implied for contracts for work and materials.[9] This is an absolute guarantee and applies also to latent defects in the materials which a supplier is not aware of, even when a supplier has exercised reasonable care.[10]

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7 N E Palmer and F D Rose, "Implied Terms in Consumer Transactions - The Australian Approach" (1977) 26 ICLQ 169, at p 173-178.

8 Law Com No. 95, at para 61-62.

9 *Halsbury's Laws of Australia*, para 40-415, note 1; para 110-2165, notes 8-9. *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46; *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454.

10 *Helicopter Sales (Aust) Pty Ltd v Rotor-Work Pty Ltd* (1974) 132 CLR 1 at p 16. Per Jacobs J: "*I do not think the question of using reasonable care arises. Proof that reasonable care was used will not absolve from liability. Therefore, I do not think it necessary to distinguish between latent defects and patent defects*." It was held that no warranty should be imported into the contract on the particular facts.

New Zealand

Implied term as to quality

5.24 The implied term as to quality in section 6 of the 1993 Act reads as follows:

> *"(1) Subject to section 41 of this Act, where goods are supplied to a consumer there is a guarantee that the goods are of acceptable quality.*
>
> *(2) Where the goods fail to comply with the guarantee in this section –*
>
> *(a) Part II of this Act may give the consumer a right of redress against the supplier; and*
>
> *(b) Part III of this Act may give the consumer a right of redress against the manufacturer."*

(a) "acceptable quality" defined in section 7

5.25 "Acceptable quality' is defined in section 7 as follows:

> *"(1) For the purposes of section 6 of this Act, goods are of acceptable quality if they are as –*
>
> *(a) Fit for all the purposes for which goods of the type in question are commonly supplied; and*
>
> *(b) Acceptable in appearance and finish; and*
>
> *(c) Free from minor defects; and*
>
> *(d) Safe; and*
>
> *(e) Durable –*
>
> *as a reasonable consumer fully acquainted with the state and condition of the goods, including any hidden defects, would regard as acceptable, having regard to -*
>
> *(f) The nature of the goods;*
>
> *(g) The price (where relevant);*
>
> *(h) Any statements made about the goods on any packaging or label on the goods;*

(i) Any representation made about the goods by the supplier or the manufacturer;

(j) All other relevant circumstances of the supply of the goods.

(2) Where any defects in goods have been specifically drawn to the consumer's attention before he or she agreed to the supply, then notwithstanding that a reasonable consumer may not have regarded the goods as acceptable with those defects, the goods will not fail to comply with the guarantee as to acceptable quality by reason only of those defects.

(3) Where goods are displayed for sale or hire, the defects that are to be treated as having been specifically drawn to the consumer's attention for the purposes of subsection (2) of this section are those disclosed on a written notice displayed with the goods.

(4) Goods will not fail to comply with the guarantee of acceptable quality if -

(a) The goods have been used in a manner, or to an extent which is inconsistent with the manner or extent of use that a reasonable consumer would expect to obtain from the goods; and

(b) The goods would have complied with the guarantee of acceptable quality if they had not been used in that manner or to that extent.

(5) A reference in subsections (2) and (3) of this section to a defect means any failure of the goods to comply with the guarantee of acceptable quality."

(b) test for "acceptable quality"

5.26 This implied term applies to all kinds of supply of goods as defined in section 2 and it therefore applies to barter, and contracts for work and materials by reason of section 15. According to section 7, "acceptable quality" means being fit for all the purposes for which goods of that kind are commonly supplied, acceptable in appearance and finish, free from minor defects, and safe and durable. The test is whether a reasonable consumer fully acquainted with the state and condition of the goods, including any hidden defects, would regard the goods as acceptable, having regard to the nature of the goods, their price, any statement on any packaging or label, any representation by the supplier or manufacturer, and any other relevant circumstances.

(c) exceptions

5.27 There are two exceptions. The first is where defects have been specifically drawn to the consumer's attention before the contract (subsection 2). The second is where goods would comply with this section but for having been used in a manner, or to any extent, which is inconsistent with the manner or extent of use that a reasonable consumer would expect to obtain from the goods (subsection 4). This implied guarantee only applies where the goods are supplied in trade (section 41), which is defined in section 2(1).

Implied term as to fitness for purpose

5.28 The implied term as to fitness for a particular purpose in section 8 of the 1993 Act is as follows:

> *"(1) Subject to section 41 of this Act, the following guarantees apply where goods are supplied to a consumer:*
>
> *(a) That the goods are reasonably fit for any particular purpose that the consumer makes known, expressly or by implication, to the supplier as the purpose for which the goods are being acquired by the consumer; and*
>
> *(b) That the goods are reasonably fit for any particular purpose for which the supplier represents that they are or will be fit.*
>
> *(2) Those guarantees do not apply where the circumstances show that –*
>
> *(a) The consumer does not rely on the supplier's skill or judgment; or*
>
> *(b) It is unreasonable for the consumer to rely on the supplier's skill or judgment.*
>
> *(3) This section applies whether or not the purpose is a purpose for which the goods are commonly supplied.*
>
> *(4) Part II of this Act gives the consumer a right of redress against the supplier where the goods fail to comply with any guarantee in this section."*

5.29 This implied term applies to all kinds of supply of goods as defined in section 2 and therefore applies to barter and contracts for work and materials by reason of section 15. Section 8 provides for a guarantee as to fitness for purpose when a consumer, expressly or by implication, makes known to the supplier any particular purpose for which the goods are acquired

or when the supplier represents that the goods fit for any particular purpose. This section does not apply where the consumer does not rely, or it is unreasonable for him to rely, on the skill or judgment of the supplier. This implied guarantee only applies where the goods are supplied in trade (section 41) which is defined in section 2(1).

Non-consumer transactions

5.30 As the 1993 Act only applies to the supply of goods to a consumer, the supply of goods to non-consumers by way of barter and contracts for work and materials is governed by common law. The court "*seems inclined to deal with contracts [of barter] as if they were analogous to contracts of sale*".[11] In respect of materials supplied by way of contracts for work and materials, there are implied terms as to fitness for purpose and good quality.[12]

England and Wales

5.31 The implied terms as to quality and fitness in section 4 of the 1982 Act read as follows:

> *"(1) Except as provided by this section and section 5 below and subject to the provisions of any other enactment, there is no implied condition or warranty about the quality or fitness for any particular purpose of goods supplied under a contract for the transfer of goods.*
>
> *(2) Where, under such a contract, the transferor transfers the property in goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality.*
>
> *(2A) For the purposes of this section and section 5 below, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.*
>
> *(3) The condition implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory –*
>
> *(a) which is specifically drawn to the transferee's attention before the contract is made,*

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11 *The Laws of New Zealand*, Vol 23, at para 54 and note 7.

12 *The Laws of New Zealand*, Vol 2, at para 74. *Batchelor's Pram House Ltd v Mckenzie Brothers Electrical Ltd* [1962] NZLR 545 at p 547.

(b) where the transferee examines the goods before the contract is made, which that examination ought to reveal, or

(c) where the property in the goods is transferred by reference to a sample, which would have been apparent on a reasonable examination of the sample.

(4) Subsection (5) below applies where, under a contract for the transfer of goods, the transferor transfers the property in goods in the course of a business and the transferee, expressly or by implication, makes known –

(a) to the transferor, or

(b) where the consideration or part of the consideration for the transfer is a sum payable by instalments and the goods were previously sold by a credit-broker to the transferor, to that credit-broker,

any particular purpose for which the goods are being acquired.

(5) In that case there is (subject to subsection (6) below) an implied condition that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied.

(6) Subsection (5) above does not apply where the circumstances show that the transferee does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the transferor or credit-broker.

(7) An implied condition or warranty about quality or fitness for a particular purpose may be annexed by usage to a contract for the transfer of goods.

(8) The preceding provisions of this section apply to a transfer by a person who in the course of a business is acting as agent for another as they apply to a transfer by a principal in the course of a business, except where that other is not transferring in the course of a business and either the transferee knows that fact or reasonable steps are taken to bring it to the transferee's notice before the contract concerned is made."

Implied condition as to satisfactory quality

5.32 Where there is a transfer of property in goods in the course of business, there is an implied condition as to satisfactory quality. According to section 18(3), "quality' includes the state, condition and aspects such as (among others) fitness for all the purposes for which goods of that kind are commonly supplied, appearance and finish, freedom from minor defects, and the safety and durability of the goods. The test, according to subsection (2A), is whether a reasonable person would regard the goods as satisfactory, having regard to their price, any description and all other relevant circumstances.

5.33 There are exceptions in subsection (3). The first is where matters making the goods unsatisfactory have been specifically drawn to a transferee's attention before the contract. The second is where a transferee's examination of the goods ought to reveal such matter. A third exception arises in the case of transfers by sample where reasonable examination of the sample would reveal such matter.

Implied condition as to fitness for purpose

5.34 Subsections (4) and (5) provide for an implied condition as to fitness for purpose where a transferor transfers property in goods in the course of business and the transferee tells the transferor or, if a credit-broker[13] had previously sold the goods to the transferor,[14] tells that credit-broker, the particular purpose of acquiring the goods. There is no such an implied term where the transferee does not rely, or it is unreasonable for him to rely, on the skill or judgment of the transferor or credit-broker (subsection (6)).

Agent for the supplier

5.35 Subsection (8) provides that this section also applies to the supply of goods by a person who, in the course of a business, acts as agent

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13 "*'credit-broker' means a person acting in the course of a business of credit brokerage carried on by him;*
'credit brokerage' means the effecting of introductions –
(a) of individuals desiring to obtain credit to persons carrying on any business so far as it relates to the provision of credit; or
(b) of individuals desiring to obtain goods on hire to persons carrying on a business which comprises or relates to the bailment [or as regards Scotland the hire] of goods under a contract for the hire of goods; or
(c) of individuals desiring to obtain credit, or to obtain goods on hire, to other credit-brokers."
Section 18(1) of the 1982 Act.

14 Geoffrey Woodroffe, *Goods and Services - The New Law* (1982, at para 3.33) provides an example. A contractor persuades a potential customer to have their products installed and offers credit facilities to be provided by a third party. The potential customer's special requirements will normally be communicated to the contractor. But the contractor may not finish up in a contractual relationship with the customer since the contractor may first supply their materials to the third party, who provides the credit facilities, and who then as transferor will enter into a credit transaction for supply to the customer. Therefore, there is a need to cover the situation where the special requirements are made known to the credit-broker (the contractor) but not the transferor (the third party).

for another. There is an exception where that other person is not supplying goods in the course of a business and either the transferee knows it or reasonable steps are taken to alert the transferee before the contract.

Notion of "caveat emptor"

5.36 The implied conditions as to quality and fitness in section 4 erodes the notion of "caveat emptor" (let the buyer beware). On the other hand, section 4(1) tries to preserve the notion by limiting the application of the implied conditions to transfers "in the course of a business"[15] (subsections (2) and (5)), transfers by sample (section 5) and situations provided in any other enactment. But subsection (7) provides that the implied conditions as to quality and fitness may be annexed by usage to a contract.[16]

Conclusion

Similarity with other jurisdictions

5.37 As mentioned under the heading of "Common law position in Hong Kong", at common law, implied terms as to quality and fitness in contracts for transfer of property in goods are likely to be similar to those for contracts of sale. Nevertheless, this should be spelt out in the form of legislation for the sake of clarity and consistency. It is clear that the implied terms as to quality and fitness for purpose concerning sale of goods in section 16 of Cap 26 are in general similar to the corresponding statutory implied terms for other kinds of supply of goods in other jurisdictions, especially section 71 of the Australian 1974 Act and section 4 of the1982 Act of England and Wales. For example, section 16(1) & (2) of Cap 26 provides for an implied condition as to quality while section16(3) provides for an implied condition as to fitness for purpose. Section 16(8) preserves the notion of "caveat emptor" and section 16(4) provides for the annexing to a contract of the implied term by usage. Section 16(5) provides for the application of the section to sale through an agent.

Differences with other jurisdictions

5.38 There are, however, also a number of differences in the statutory implied terms applied to contracts for the supply of goods in other jurisdictions. These differences shed some light on how we should formulate the implied terms as to quality and fitness for other kinds of contracts for the supply of goods in Hong Kong.

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15 "Business" is defined in section 18(1) to include "*a profession and the activities of any government department or local or public authority*". In most cases, it should be clear whether a transfer is a business transaction or not.

16 The usage must fulfil all the tests of a custom and be reconcilable with the terms of the contract. *Peter Arlington Partners Ltd v Gosho Co Ltd* [1964] 1 Lloyd's Rep 149.

(a) the test for the requirement as to "quality"

5.39 First, as to the test for "quality", both section 2(5) of Cap 26 and section 66(2) of the Australian 1974 Act stipulate that goods are of merchantable quality if they are as *"fit for the purpose or purposes …as it is reasonable to expect …*" Section 7(1) of the New Zealand 1993 Act stipulates that goods are of acceptable quality if they are as *"[f]it for all the purposes …as a reasonable consumer …would regard as acceptable*". Section 4(2A) of the 1982 Act of England and Wales stipulates that *"goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory"*. In other words, both the New Zealand and England and Wales versions postulate a reasonable man test.

5.40 The problem with the tests in both Cap 26 and the Australian 1974 Act is that they may lower the statutory standard of the "quality" required when a supplier can establish that goods of a particular kind (for example, new cars), can reasonably be expected to have a number of minor defects upon delivery. For example, it has been held[17] that a car delivered with a slight oil leak in its power-assisted steering system was of merchantable quality. In a subsequent case, the Court of Appeal held[18] that a car delivered with oil seals leaking was unmerchantable within the meaning of the Sale of Goods Act 1979 of England and Wales.[19]

5.41 The Law Commission[20] of England and Wales was of the view that, although *Rogers v Parish (Scarborough) Ltd* made it clear that a car was still unmerchantable even if it managed to run safely, it was unclear whether complicated goods like cars with trivial defects were merchantable. "*Do the words 'as it is reasonable to expect' in section 14(6)[21] really mean that [such minor] defects do not render the car [or any goods] unmerchantable within section 14(2)?*"[22]

5.42 The Law Commission recommended the reasonable man test to replace the "as it is reasonable to expect" test and stated:

> *"The 'reasonable person' would not, in general, find the standard of goods to be 'acceptable' if they had minor or cosmetic defects - certainly if the goods were new. But the test of the reasonable person would also permit a lower standard where only a lower standard could reasonably be demanded - for example, where the goods were second-hand, or 'seconds' sold at a suitably low price."*[23]

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17 *Millars of Falkirk Ltd v Turpie* 1976 SLT (Notes) 66. This is a Scottish case and the test of "merchantable quality" at the time was identical to that in the present section 2(5) of Cap 26 ("as it is reasonable to expect" test).

18 *Rogers v Parish (Scarborough) Ltd* [1987] 2 WLR 353.

19 The test of "merchantable quality" in the then 1979 Act was identical to that in the present section 2(5) of Cap 26 ("as it is reasonable to expect" test).

20 Law Com No 160, 1987, at para 2.13.

21 Sale of Goods Act 1979.

22 Law Com No 160, 1987, at para 2.13.

23 Law Com No 160, 1987, at para 3.24. *"If a particular type of product was often defective, then a buyer might be taken reasonably to expect this and thus be prevented from making a*

5.43 The Sale and Supply of Goods Act 1994 of England and Wales put the above recommendation into effect by amending the tests in the 1979 Act and legislation concerning other kinds of supply of goods (ie the 1973 Act and 1982 Act). The New Zealand 1993 Act also adopted the reasonable man test. Professor Atiyah has said that tests which depend so heavily upon standards of reasonableness tend to be somewhat circular in practice.[24] Professor Bridge has also said that the test is circular: goods are of satisfactory quality if a reasonable person would regard them as satisfactory.[25] On the other hand, Alan Wilson has made the following comments:

> *"Since the test is to be applied to such a wide range of goods it is inevitable that a certain amount of objectivity is necessary. It is therefore, a welcome development that the 'reasonable person' test is expressly incorporated … [T]he definition of satisfactory quality introduces a reasonable person test understandable to both consumer and supplier, while at the same time providing the necessary element of flexibility."*[26]

5.44 In Hong Kong, section 2(5) of Cap 26 stipulates the "as it is reasonable to expect" test. We agree with the Law Commission that "*[the reasonable man] test is a more helpful [test] for retailers, consumers and their advisers while remaining appropriate for more sophisticated buyers and sellers*".[27] It can rule out the possibility that it is reasonable to expect, under the existing provision, some minor defects upon delivery of the goods which can then be regarded as merchantable. The test has been criticised as circular. But it provides a yardstick (a reasonable person would regard the goods as satisfactory) to assess the quality of the goods not in isolation, but in the context of their price, any description and all other relevant circumstances. We therefore recommend that the reasonable man test should be adopted for other kinds of supply of goods to be regulated in the Recommended Legislation.

(b) meaning of "quality"

5.45 The second difference concerns the meaning of "quality". Section 66(2) of the Australian 1974 Act stipulates only one aspect of "quality" which is fitness for purpose or purposes. On the other hand, section 2(5) of Cap 26, section 18(3) of the 1982 Act of England and Wales and section 7(1) of the New Zealand 1993 Act stipulate not just an aspect of fitness for purpose, but also appearance and finish, freedom from minor defects, safety and durability. The list of aspects of "quality" in England and Wales is non-

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successful claim under s14(2) - leaving him without any remedy and encouraging a lowering of standards. Hence, the new standard is that which a reasonable person would regard as satisfactory, rather than the standard he might, in practice, expect. At the same time, the new standard is flexible enough to allow a lower standard where the goods are second-hand." Patrick Milne, "Goodbye to merchantable quality", [1995] NLJ 683 at p 683.

24 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 140.

25 M Bridge, *The Sale of Goods*, 1997, at p 304.

26 Alan Wilson, "Faulty goods, faulty law", (1995) 5 CPR 135, at p 139 and 141.

27 Law Com No 160, 1987, at para 3.22.

exhaustive since it is expressly qualified by the words, "among others", while the lists in Cap 26 and New Zealand are exhaustive.

5.46 The previous version of the meaning of "quality" in Cap 26 only mentioned fitness for purpose. This was amended in 1994[28] to cover four other aspects of quality similar to the equivalent provisions[29] in England and Wales. The amendment in 1994 did not spell out clearly whether the list is exhaustive. Before the 1994 amendment, the concept of fitness for purpose had already been extended beyond mere functional fitness and was regarded as only one among many aspects of quality.[30] The 1994 amendment put it beyond doubt that the expression "quality" covers at least four aspects other than fitness for purpose.

5.47 To leave room for other possible aspects of quality not included in the statutory list, we recommend that the list of aspects of quality should be expressly stated to be non-exhaustive in the Recommended Legislation. We are attracted to the following recommendation of the Law Commission of England and Wales:

> *"[w]e recommend a wider list, in which no one element would have priority, in which not all the elements would always be relevant, and which would leave room for other, unlisted, matters to be taken into account".*[31]

(c) "fitness for all the purposes ..."

5.48 The third difference relates to "fitness for purpose" within the meaning of "quality". Section 2(5) of Cap 26 and section 66(2) of the Australian 1974 Act require the goods, in order to be merchantable, to be "*fit for the purpose or purposes for which goods of that kind are commonly bought*". Section 18(3) of the English 1982 Act and section 7(1) of the New Zealand 1993 Act require the goods, in order to be "satisfactory" (or "acceptable"), among other things, to be fit for all the purposes for which goods of the type in question are commonly supplied.

5.49 Before the present requirement as to "fit for the purpose or purposes ..." was introduced to Cap 26 in 1977,[32] the House of Lords had held[33] in 1969 that goods could be merchantable though not fit for all their purposes. With the introduction of the present requirement in 1977, there was ambiguity as to whether the goods must be fit for all their normal purposes.

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28 Sale of Goods (Amendment) Ordinance 1994.

29 Section 14(2B) of the 1979 Act; section 18(3) of the 1982 Act; section 10(2B) of the 1973 Act.

30 *Rogers v Parish (Scarborough) Ltd* [1987] QB 933. The Australian Full Court also held that the reference in the statutory definition to purposes was not limited to functional considerations, but might also include the cosmetic appearance of the goods. Accordingly aesthetic considerations might be taken into account in judging whether or not goods were of merchantable quality; *Rasell v Cavalier Marketing (Aust) Pty Ltd* [1991] 2 Qd R 323 at p 348-51.

31 Law Com No 160, 1987, at para 3.29.

32 It was introduced by section 2 of the Sale of Goods (Amendment) Ordinance (Ord No 58 of 1977), following the English 1973 Act.

33 *Henry Kendall & Sons v William Lillico & Sons Ltd* [1969] 2 AC 31.

But in 1987 the English Court of Appeal held[34] that goods did not necessarily need to be fit for all their normal purposes in order to be merchantable under the present requirement.

5.50 After referring to this ruling, the Law Commission recommended a change such that goods should be fit for all their normal purposes in order to be merchantable. Its report[35] prompted the Sale and Supply of Goods Act 1994 which introduced such a provision to section 18(3) of the English 1982 Act. The Law Commission has stated that as a matter of policy, there should be such a change and has concluded:

> *"Although not without doubt on the part of some of us, we have reached the conclusion that the latter view is preferable, and that goods of a particular description and price should be fit for all their common purposes unless there is an indication to the contrary. If the buyer has a particular uncommon purpose in mind it is always open to him to make this known to the seller, and rely on section 14(3) of the 1979 Act. If, on the other hand, the seller knows that his goods are not fit for one or more of the purposes for which goods of that kind are commonly supplied, he may ensure that the description of the goods excludes any common purpose for which they are unfit, or otherwise indicates that the goods are not fit for all their common purposes. If he does not do so, and it is not clear from the other circumstances, then the seller may be in breach of the implied quality term if he sells goods which are commonly supplied for two purposes but which are fit for only one."*[36]

5.51 Geraint Howells has welcomed the change and has said: "*it is pleasing to see that there is a requirement that goods should be fit for all their common purposes.*"[37] Professor Bridge, however, has argued that the Law Commission should have explored the matter more fully and, in particular, considered whether the change would be as appropriate for commercial as for consumer transactions.[38] We are of the view that there should be no differentiation between commercial and consumer transactions in this respect.

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34 In *M/S Aswan Engineering Establishing Co v Lupdine Ltd* [1987] 1 WLR 1, the plaintiff bought waterproofing compound in plastic pails for export to Kuwait from the 1st dependant who had bought the same from the 2nd defendant. When the pails were unloaded in Kuwait, they were stacked to six pails high under the intense sun (60°C-70°C) for some days. The pails collapsed under their own weight and the waterproof compound was lost. The pails were fit for most purposes for which such pails would be used, but not for stacking six pails high in such intense heat. The Court of Appeal held that the pails satisfied the requirement as to "as fit for the purpose or purposes ..." introduced to the Sale of Goods Act by the 1973 Act.

35 Law Commission, *Report on Sale and Supply of Goods* (1987), Law Com No 160.

36 Law Com No 160, 1987, at para 3.36. Professor Bridge has commented that the "*Law Commission's abstract reasoning does not make a persuasive case for such a change*." M Bridge, "British Business Law - Commercial Sales: The Sale and Supply of Goods Act 1994", [1995] JBL 398, at p 401.

37 Geraint Howells, "The Modernisation of Sales Law? The Sale and Supply of Goods Act 1994", [1995] LMCLQ 191, at p 194.

38 M Bridge, *The Sale of Goods*, 1997, at p 307.

5.52 Professor Bridge has also said that there are uncertainties as to what amounts to "appropriate cases"[39] in which to make a supplier liable in respect of all common purposes, and how to differentiate between common and particular purposes. At the same time, probably because of these uncertainties, academics appear to find that the new requirement allows courts room to manoeuvre. Professor Goode has pointed out that the reference to "appropriate cases" enables suppliers to make it clear in their description of the goods that the goods are not fit for all common purposes.[40] Professor Reynolds has stated that the reference to the purpose for which goods are commonly supplied may preserve some flexibility for courts.[41] Both Professor Bridge[42] and Professor Atiyah[43] are of the view that even applying the new requirement to the *Aswan Engineering* case, the court would probably find the purpose in question uncommon and come to the same conclusion.

5.53 In addition, Professor Bridge has commented that it may not be appropriate to permit a buyer to reject unwanted goods just because the goods are not fit for a common purpose for which he has no intention to use them. This is especially the case when a buyer has informed the seller that his purpose is a different one.[44] On the other hand, it would seem reasonable for a buyer to expect that the goods are fit for all the purposes for which such goods are commonly supplied. As the Law Commission has pointed out, this is a policy decision as to the side of which the law places greater emphasis. As pointed out above, under the new requirement, even though goods are required to be fit for all their common purposes in order to be merchantable, there is still flexibility for both suppliers and courts.

5.54 We conclude that as a matter of policy, a buyer should be entitled to expect that the goods are fit for all the purposes for which such goods are commonly supplied, even though he may not need the goods for all those purposes himself. We therefore recommend that goods should be fit for all their common purposes in order to be merchantable.

(d) "merchantable quality"

5.55 The fourth difference concerns the term "merchantable quality". Section 16 of Cap 26 and section 71 of the Australian 1974 Act retain the term "merchantable quality". Section 7 of the New Zealand 1993 Act adopts the term "acceptable quality". Upon the recommendation of the Law

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39 Section 18(3) of the 1982 Act provides: "*…the following (among others) are in appropriate cases aspects of the quality of goods …(a) fitness for all the purposes for which goods of the kind in question are commonly supplied …*".

40 R Goode, *Commercial Law*, 2nd Ed, 1995, at p 323. But Professor Bridge has mentioned that "*a seller's narrow description, which is taken into account in defining the standard of satisfactory quality in a given case, might also be seen as an attempt to exclude liability under section 14(2) [of the 1979 Act].*" M Bridge, "British Business Law - Commercial Sales: The Sale and Supply of Goods Act 1994", [1995] JBL 398, at p 401.

41 F Reynolds, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 11-050.

42 M Bridge, *The Sale of Goods*, 1997, at p 307.

43 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 143.

44 M Bridge, *The Sale of Goods*, 1997, at p 307.

Commission,[45] section 4 of the 1982 Act of England and Wales was amended[46] by the Sale and Supply of Goods Act 1994 to replace the term "merchantable quality" with "satisfactory quality".

5.56 The Law Commission was of the view[47] that the term "merchantable" referred to transactions between merchants, was not appropriate for consumer transactions, and was of uncertain meaning and largely obsolete. It further stated:

> *"the word 'merchantable' was derived from Victorian cases where (putting the matter at its simplest) the question was, 'were the goods of such a quality that one merchant buying them from another, would have regarded them as suitable?' …[It] was gradually seen not to be suitable for all cases. On its face the word is not suitable for non-mercantile transactions. It became necessary for judges to explain what the word meant. In some cases it was said to mean that the goods had to be fit for their purpose. In other cases it was said that the goods had to be acceptable."*[48]

5.57 Some academics have welcomed the replacement of the term "merchantable". Alan Wilson has mentioned that the change "*is a simple but effective one …[and] the outdated term merchantable quality is replaced by the more legitimate satisfactory quality in accordance with consumer expectations*."[49] Geraint Howells[50] has stated that the change might bring significant benefits to buyers if the courts treated that as a signal to provide a more purposive application of the term. Jennifer Hamilton has commented: "*[c]onsumer groups have generally welcomed the replacement of 'merchantable quality' with an implied term that takes into account such things as freedom from minor defects . ..*".[51] Iwan Davies[52] has also said:

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45 Law Com No 160, 1987, para 3.19. The Law Commission recommended the term "acceptable quality" in its report. The UK Government preferred "satisfactory quality" to "acceptable quality", the proposer of the Bill suggesting that "satisfactory" was of a higher standard than "acceptable" (Lord Dormand of Easington (22 July 1994) HL Deb, 556 Col 473).
"*However, another explanation for the change in terminology was the fear that confusion may arise between the rules on remedies, where acceptance is a familiar term, and the standard expected of goods, if acceptable quality were adopted as the standard*." Geraint Howells, "The Modernisation of Sales Law? The Sale and Supply of Goods Act 1994", [1995] LMCLQ 191, at p 192. At n 8, Howells said, "*[t]his point was made by the DTI following consultation on the Law Commission proposals*." For this Paper, the discussion in Law Com No 160, 1987 is also relevant since the question is whether the term "merchantable" should be replaced.

46 The same amendments were made to section 10 of the 1973 Act and section 14 of the 1979 Act by the Sale and Supply of Goods Act 1994.

47 Law Com No 160, 1987, para 3.5.

48 Law Com No 160, 1987, para 3.7.

49 Alan Wilson, "Faulty Goods, Faulty Law" (1995) 5 CPR 135, at p 139 and 141.

50 Geraint Howells, "The Modernisation of Sales Law? The Sale and Supply of Goods Act 1994" [1995] LMCLQ 191, at p 191. At p 193, he further stated "*one of the great practical benefits … is that consumers will not be met by the technical term 'merchantable quality' and will feel more confident that their understanding of what is 'satisfactory' is as justified as that of the sellers*."

51 Jennifer Hamilton, "Cases and Comment - the Sale and Supply of Goods Act 1994" [1995] JR 385, at p 386.

52 Iwan Davies, *Sale and Supply of Goods,* 2nd Ed,1996, at p 55.

"[t]he adoption of 'satisfactory' does have the advantage of communicating to consumers the standard required in a more meaningful way than does merchantability."

5.58 These views were shared by the Australian Full Court[53] which held that the term "merchantable quality' was to be given its ordinary meaning, and was to be interpreted without reference to common law definitions. It was unnecessary and undesirable to look to the common law definition of merchantability for the purposes of section 66(2) (about the meaning of merchantable quality) of the 1974 Act. The common law tests relate to saleability of goods which are tests of merchants and are more appropriate to commercial sales. The 1974 Act ought to be interpreted against the background of its remedial character of giving consumers rights and protections which were not available previously.

5.59 However, some academics were lukewarm as to the replacement of "merchantable quality" by "satisfactory quality" since:

"[i]t is a question of judgment whether goods can properly be described as 'merchantable' or 'acceptable' …or 'satisfactory'. Whichever term is employed does not dispense with the need to devise criteria by which to make that judgment, so that the term chosen is of minor significance in comparison with the specific rules intended to assist the process of decision". [54]

5.60 Brian Childs has pointed out that whether goods are "merchantable", "acceptable" or "satisfactory" is a matter of interpreting the criteria devised behind the label chosen, and the label itself is of less significance. Professor Reynolds has mentioned that the change to "satisfactory quality" involves the substitution of a phrase "*which meant something but was inappropriate to commercial disputes by a phrase which as elaborated is little more than circular for any dispute*."[55] Professor Atiyah has also been critical:

"The concept of 'satisfactory quality', it must be said, has even less genuine meaning than the concept of 'merchantable quality', and must be fleshed out by the case law in varying circumstances, and unfortunately, as previously suggested, the effect of the new proposals will be to sever this country from the useful lines of authority which have developed in other common law jurisdictions on the meaning of 'merchantability'. Worse still, for many people the word 'satisfactory' implies a fairly mediocre standard …"[56]

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53 *Rasell v Cavalier Marketing (Aust) Pty Ltd* [1991] 2 Qd R 323, at p 348.

54 Brian Childs, "Goodbye to all that?" (1995) 46 NILQ 232, at p 234.

55 F Reynolds, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 11-057. He has also described the change as a *"substitution of a less commercial (but in consequence rather circular and anodyne) term for 'merchantable' …"* at para 11-049.

56 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 153-154.

5.61 We have dealt with the comment as to circularity earlier in this chapter in the section dealing with the test for the requirement as to "quality". As regards the suggestion that a change from "merchantable" to "satisfactory" would cause the loss of the useful lines of authority from other jurisdictions, it should be pointed out that the existing provisions in Cap 26 relating to quality in contracts for the sale of goods already differ from those elsewhere in some respects.[57] In the context of other types of supply of goods, only section 66(2) of the Australian 1974 Act is the same as that in Cap 26. As to the contention that the adoption of "satisfactory" rather than "merchantable" implies a mediocre standard, we agree with Brian Childs that it is the criteria devised behind the label chosen (but not the label itself) that matter. In any event, "satisfactory" sets a higher standard than "acceptable". Since the term "merchantable" has a strong connotation of, and emphasis on, the saleability of the goods and is not totally in tune with everyday consumer transactions, on balance we recommend replacing it with "satisfactory", which is a more modern and general expression.

(e) the inclusion of "state or condition"

5.62 The fifth difference relates to the inclusion of "state or condition". In Cap 26, "quality" is defined to include the "state or condition" of the goods, which is put in a separate sub-section of section 2. In section 18(3) of the 1982 Act of England and Wales, "state and condition" is put together with the non-exhaustive lists of aspects of "quality" in the same sub-section. For the sake of clarity and convenience, we recommend that "state or condition" be put together with the list of aspects of "quality" in the same sub-section.

(f) "antecedent negotiations"

5.63 The sixth difference concerns the particular purpose made known to a supplier (seller, transferor, etc depending on the type of contract). In section 16(6) of Cap 26 and section 71(2) of the Australian 1974 Act, the references to a seller include a person by whom any antecedent negotiations are conducted. In section 14(3) of the 1979 Act and section 4(4) of the 1982 Act,[58] the references to a seller are extended to cover "credit-brokers". There is no similar provision in the New Zealand 1993 Act.

5.64 In England and Wales, in order to be covered by the relevant provisions,[59] a credit-broker must have previously sold to the supplier (seller, transferor, bailor etc, depending on the type of contract) the goods in question. Under section 16(7) of Cap 26, antecedent negotiations means any negotiations or arrangement with a buyer whereby he was induced to make

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[57] See section 19(2) of the Sale of Goods Act 1923 (NSW), section 16(b) of the Sale of Goods act 1908 (New Zealand) and section 15(2) of the Sale of Goods Act, Revised Statutes of Ontario, 1990, C s1.

[58] The concept "credit broker" also appears in section 9(4) of the 1982 Act and section 10(3) of the 1973 Act. The concept "credit broker" were introduced by the Consumer Credit Act 1974. Ultimately, all the statutes governing the implied terms of various kinds of contracts for the supply of goods include the concept "credit broker" regarding the persons to whom the particular purpose should be made known.

[59] Section 14(3) of the 1979 Act; section 4(4) of the 1982 Act; section 9(4) of the 1982 Act and section 10(3) of the 1973 Act.

the agreement or which otherwise promoted the transaction. The expression "antecedent negotiations" in Cap 26 covers more situations than the dealings with credit-brokers as adopted in England and Wales. The possible effect of a provision adopting the concept "antecedent negotiations" is wider than that adopting the concept of "credit-brokers".

5.65 The concept "credit-broker" was introduced by specific provisions in the Consumer Credit Act 1974, and there is no equivalent statute governing consumer credit in Hong Kong. Section 16(6) and (7) of Cap 26 was introduced in 1973 and has been in operation since then. Unless there is good reason to replace the concept "antecedent negotiations", we recommend following the concept "antecedent negotiations" in Cap 26 for other types of contracts for supply of goods in the Recommended Legislation for the sake of consistency.

Consequential amendment to Cap 26

5.66 We must point out that it will be necessary to amend the equivalent provisions in Cap 26 consequentially for the sake of consistency if the recommendations in paragraphs (a) to (e) above are enacted in the Recommended Legislation.

Recommendation 12

We recommend that implied terms about quality and fitness similar to those in section 16 of Cap 26 be enacted for both consumer and non-consumer contracts for transfer of property in goods with some appropriate amendments, namely:

(a) (i) where a transferor transfers the property in goods in the course of a business, there should be an implied condition that the goods supplied are of satisfactory quality except:

- **the defects which have been specifically drawn to the transferee's attention before the contract;**
- **where the transferee examines the goods before the contract, the defects which ought to have been revealed by that examination; or**
- **where the contract is one by reference to a sample, the defects which would have been apparent on a reasonable examination of the sample;**

(ii) the test of "satisfactory quality" should be the standard of a reasonable person who regards the goods as satisfactory, taking account of their description, the consideration for the supply of goods and other relevant circumstances;

(iii) the inclusion of consideration of "state or condition" in assessing "quality" should be put together, in the same sub-section, with the list of aspects of "quality", which should be non-exhaustive;

(iv) in the list of aspects of "quality", goods are required to be fit for all their common purposes;

(b) (i) where a transferor transfers the property in goods in the course of a business, and the transferee expressly or impliedly makes known to the transferor (or any person who conducts any antecedent negotiations), any particular purpose for acquiring the goods, there should be an implied condition that the goods are reasonably fit for that purpose except where:

- the transferee does not rely; or
- it is unreasonable for him to rely,

on the skill or judgment of the transferor or the person who conducted the antecedent negotiations;

(ii) "antecedent negotiations" means any negotiations or arrangements with a transferee whereby he was induced to make the agreement or which otherwise promoted the transaction;

(c) the implied condition or warranty as to quality or fitness for a particular purpose may be annexed to a contract by usage;

(d) the foregoing provisions should apply to a transfer of goods by a person who in the course of a business is acting as agent for another in the same way that they apply to a transfer by a principal in the course of a business, except where:

- that other is not transferring goods in the course of a business; and

- **the transferee knows this, or reasonable steps have been taken to let the transferee know this before the contract;**

(e) the notion of "caveat emptor" should be preserved to the extent by limiting the application of the implied condition or warranty as to quality and fitness for a particular purpose to transfers "in the course of a business", transfers by sample and other situations provided in other enactments.

Contracts of hire

Common law position in Hong Kong

5.67 There is uncertainty in the existing law as to the nature and extent of a bailor's obligations regarding quality and fitness for purpose of goods hired out. Although there are some decided cases concerning the implied obligations of a bailor in relation to fitness for purpose of goods, the courts have seemed to follow three main lines of thought regarding liability.[60]

Approach A —strict liability for ensuring that goods are reasonably fit for their purposes

5.68 One line of authority suggests that a bailor is strictly liable for ensuring that goods are reasonably fit for the purposes for which they are required. This was the approach taken by Kelly C B in *Jones v Page*[61] and *Francis v Cockerell,*[62] Pollock C B in *Chew v Jones,*[63] and by Mathew J in

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60 Law Commission, *Law of Contract, Implied Terms in Contracts for the Supply of Goods*, Working Paper No 71, 1977, at para 49. See also G W Paton, *Bailment in the Common Law*, 1952, at p 292.

61 In *Jones v Page* [1867] 15 LT (NS) 619, the plaintiff, an inn-keeper, took on hire from the defendant an omnibus which was held to be unfit for the journey. The court held the defendant liable. The opinions of the judges differed. Kelly C B thought that the vehicle should be *safe and fit for the purpose*. Kelly C B has said at p 620, "*a person letting out a carriage for hire does, in law, undertakes that it shall be reasonably and duly safe and fit for the particular purpose …*" He was therefore of the opinion that the owner, as to fitness for purpose, was under a similar strict liability as that under contracts for the sale of goods.

62 *Francis v Cockerell* [1870] LR 5 QB 501, dealt with occupier's liability but the reasoning in the judgment of Kelly C B was clearly based on the analogy of hire. The defendant had engaged contractors to erect a stand at a race course. The contractors did the work negligently but the defendant did not know this and the defendant was not personally negligent in this respect. Members of the public, of whom the plaintiff was one, paid the defendant to use the stand to watch the races and were injured when the stand collapsed. The issue was whether the defendant was liable to the plaintiff for breach of contract and it was held unanimously that he was. Kelly C B gave the leading judgment at p 504, *"I do not hesitate to say that I am clearly of the opinion, as a general proposition of law, that when one man engages another to supply him with a particular article or thing, to be applied to a certain use and purpose, in consideration of a pecuniary payment, he enters into an implied contract that the article or thing shall be*

Hyman v Nye[64] and *Vogan & Co v Oulton.*[65] Under this approach, a bailor is liable even for defects in the goods which he could not possibly have discovered. Under Cap 26, liability is also strict in this sense.[66]

Approach B —as fit as reasonable skill and care can make

5.69 A second line of authority suggests that a bailor is liable unless the goods supplied are as fit for the purposes for which they are required "as reasonable skill and care can make them". This was the approach first taken by the majority judges in *Francis v Cockerell*[67] and by Lindley J in *Hyman v Nye,*[68] and the wording was that adopted in *Read v Dean.*[69] Negligence will

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reasonably fit for the purpose for which it is to be used and to which it is to be applied." It seems that Kelly C B took the same approach as he had done in *Jones v Page*.

63 In *Chew v Jones* [1847] 10 LT (OS) 231, a horse was hired out but proved to be unfit for the journey for which it had been hired. Pollock CB found in favour of the hirer. He said, *"[I]f a horse or carriage be let out for hire, for the purpose of performing a particular journey, the party letting warrants that the horse or carriage, as the case may be, is fit and proper and competent for such a journey."* Pollock C B's approach was therefore similar to the approach of Kelly C B in *Jones v Page*.

64 In *Hyman v Nye* [1881] 6 QBD 685, the defendant hired out a carriage to the plaintiff for a journey. On the journey a bolt in the carriage broke and there was an accident. The plaintiff appealed and his appeal was allowed on the ground that the defendant's duty was higher than that of "reasonable care" and that the duty had been broken. The appeal judges took different approaches when they allowed the appeal. Mathew J was inclined to a strict liability approach similar to that under a contract of sale. He has said at p 689, *"It appears to me that the question which the jury ought to have been asked was, whether the carriage was, in fact, reasonably safe when it was hired to the plaintiff. The cases ... seem to show that there is no distinction in this respect between contracts for the sale and for the hire of an article for a specific purpose, where trust is reposed in the person who, in the ordinary course of business sells or lets to hire."*

65 In *Vogan & Co v Oulton* [1898] 79 LT 384, the plaintiffs hired 3000 sacks from the defendant for use in unloading a cargo of peas. One of the plaintiff's employees was injured when one of the sacks full of peas broke while being hoisted. Wright J held the defendant liable to the plaintiffs for breach of an implied term that the sacks should be *reasonably fit for the purpose for which they were supplied*. This seems to be a strict liability approach, similar to Kelly C B's approach in *Jones v Page* and *Francis v Cockerell*.

66 The point is illustrated by *Frost v Aylesbury Dairy Co* [1905] 1 KB 608 in which case the milk sold contained typhoid germs. No skill or care could have enabled the dairy company to detect the germs, having regard to the state of medical knowledge at that time. Nevertheless, the dairy company was held liable.

67 Keating, Montague Smith and Cleasby J J thought that the obligation was to provide an article that was reasonably fit for the purpose for which it was to be used "*so far as the exercise of reasonable skill and care should make it so*". They held that the defendant, though not personally negligent, was liable because he was responsible for the negligence of his contractors. These judges had therefore adopted a different approach: that a supplier of goods should be liable for supplying goods that are not as fit as reasonable skill and care can make them.

68 Lindley J arrived at the same conclusion but took a different approach. He has said at p 687, "[h]is duty appears to me to be to supply a carriage *as fit for the purpose for which it is hired as care and skill can render it*; *and if whilst the carriage is being properly used for such purpose it breaks down, it becomes incumbent on the person who has let it out to show that the break down was in the proper sense of the word an accident not preventable by any care or skill .... Nor does it appear to me to be at all unreasonable to exact such vigilance from a person who makes it his business to let out carriages for hire*." His approach was therefore similar to that of the majority judges in *Francis v Cockerell*.

69 In *Read v Dean* [1949] 1 KB 188, the plaintiffs hired a motor launch from the defendant. There was something wrong with the engine. The judge found the defendant liable and held that it was an implied term that the thing hired should be *as fit for the purpose for which it was hired as reasonable skill and care could make it* and that this duty had been broken. This approach was similar to Lindley J's approach in *Hyman v Nye*.

be presumed unless it is rebutted and the absence of negligence on a bailor's part is not by itself a defence. A bailor will be liable if the goods are unfit through negligence on another's part. The duty on a bailor is not as stringent as that under Approach A above.

Approach C —negligence-based

5.70 A third line of authority suggests that a bailor is only liable for the fitness of the goods hired out to the extent that there has been negligence on his part or on the part of those for whom he is responsible. This approach was taken by Piggott B in *Jones v Page,*[70] and at first instance in *Hyman v Nye*. This approach seems to have found the least favour.

5.71 Since *Read v Dean*, the courts seem to have been following the approach that a bailor should supply goods as fit for the purpose for which they were hired as reasonable care and skill could make them. This was the formula of words propounded in *Read v Dean*. Similar words were used by Upjohn LJ in *Astley Industrial Trust Ltd v Grimley*[71] which was a case concerning hire purchase of a truck. However, the Court of Appeal held that on the facts of the case the bailor had excluded its liability by the terms of the contract.

5.72 There is no indication in any of these cases that the judges' attention was drawn to the implications of the different approaches.[72] In addition, there is a division of opinion among academics. One academic is of the view that the weight of authority favours absolute liability,[73] while others take a different view.[74] The existing common law position is therefore unclear, a fact alluded to by the Law Commission of England and Wales, when commenting on the common law position before the enactment of the 1982 Act.[75]

Australia

5.73 For consumer contracts of hire, there are implied conditions as to quality and fitness for purpose in section 71 of the 1974 Act, since "supply" is defined in section 4 to include "hire". The discussion above under the heading "Contracts for transfer of property in goods" therefore also applies to contracts of hire.

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70 Piggott B agreed with the result but seemed to have taken a slightly different view. He has said at p 621, "*[w]e do not by our decision make the defendant an insurer in any event, but merely hold that, as a letter of a vehicle out for hire, he was bound to use proper and ordinary care that it was reasonably fit and proper for the purpose.*" Therefore, it seems that Piggott B held the supplier liable for the unfitness of the goods only to the extent of any negligence on the part of the supplier, or of someone for whom the supplier was liable.

71 [1963] 1 WLR 584.

72 *Law of Contract, Implied Terms in Contracts for the Supply of Goods*, Law Com WP No 71 (1977) at para 57.

73 Paton, *Bailment in the Common Law*, 1952, at p 298.

74 "*[T]he warranty of reasonable fitness in hire lies almost midway between the absolute condition laid down in the case of sales and the mere duty of reasonable care imposed by the law of tort, but nearer the former than the latter.*" *Crossley Vaines' Personal Property*, 5th Ed, 1973 at p 414.

75 Law Com WP No 71 (1977) at para 58.

5.74 For non-consumer contracts of hire, the balance of opinion at common law inclines to the view that a bailor is under a duty of absolute care to ensure the quality and fitness for purpose of the goods,[76] and that the term is a condition, rather than a warranty.[77] In Victoria, a condition as to merchantable quality is implied into contracts for the lease of goods.[78]

New Zealand

5.75 The implied conditions as to quality and fitness for purpose in sections 6-8 of the 1993 Act apply to consumer contracts of hire, since "supply" is defined in section 2 to include "hire". The discussion above under the heading "Contracts for transfer of property in goods" also applies to contracts of hire.

5.76 For non-consumer contracts of hire, there is no direct case law on the point even though there is an implied warranty that a hirer will enjoy quiet possession for the period of hire.[79]

England and Wales

5.77 The implied terms as to quality and fitness for purpose in section 9 of the 1982 Act read as follows:

> *"(1) Except as provided by this section and section 10 below and subject to the provisions of any other enactment, there is no implied condition or warranty about the quality or fitness for any particular purpose of goods bailed under a contract for the hire of goods.*
>
> *(2) Where, under such a contract, the bailor bails goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality.*
>
> *(2A) For the purposes of this section and section 10 below, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the*

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76 *Derbyshire Building Co Pty Ltd v Becker* (1962) 107 CLR 633 at p 645 per McTiernan J, at p 649 per Kitto J, at p 656 per Taylor J, at p 659-60 per Winderyer J; *Cottee v Franklins Self-serve Pty Ltd* (unreported, CA (QLD), Macrossan CJ, McPherson JA, Moynihan J, No 91 of 1995, 28 Nov 1995); see also *Halsbury's Laws of Australia* para 40-320.

77 *Criss v Alexander* (1928) 28 SR (NSW) 297 at p 300-301; *AS James Pty Ltd v Duncan* [1970] VR 705; see also *Halsbury's Laws of Australia,* at para 40-320.

78 (Vic) Goods Act 1958 s106. In the Northern Territory, South Australia and Western Australia, such an implied condition is implied into consumer contracts only: (NT) Consumer Affairs and Fair Trading Act 1990 s64; (SA) Consumer Transactions Act 1972 s8(4); (WA) Fair Trading Act 1987 s38. There is no equivalent provision in other jurisdictions.

79 See *The Laws of New Zealand*, "Bailment", at para 58.

consideration for the bailment (if relevant) and all the other relevant circumstances.

(3) The condition implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory –

(a) which is specifically drawn to the bailee's attention before the contract is made,

(b) where the bailee examines the goods before the contract is made, which that examination ought to reveal, or

(c) where the goods are bailed by reference to a sample, which would have been apparent on a reasonable examination of the sample.

(4) Subsection (5) below applies where, under a contract for the hire of goods, the bailor bails goods in the course of a business and the bailee, expressly or by implication, makes known –

(a) to the bailor in the course of negotiations conducted by him in relation to the making of the contract, or

(b) to a credit-broker in the course of negotiations conducted by that broker in relation to goods sold by him to the bailor before forming the subject matter of the contract,

any particular purpose for which the goods are being bailed.

(5) In that case there is (subject to subsection (6) below) an implied condition that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied.

(6) Subsection (5) above does not apply where the circumstances show that the bailee does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the bailor or credit-broker.

(7) An implied condition or warranty about quality or fitness for a particular purpose may be annexed by usage to a contract for the hire of goods.

(8) The preceding provisions of this section apply to a bailment by a person who in the course of a business is acting as agent for another as they apply to a bailment by a principal in the course of a business, except where that other is not bailing in the course of a business and either the bailee knows that fact or reasonable steps are taken to bring it to the bailee's notice before the contract concerned is made."

5.78 As with contracts for the transfer of property in goods, there are implied conditions as to quality and fitness for purpose in both consumer and non-consumer contracts of hire. Section 9 is very similar to section 4 of the 1982 Act, and therefore the discussion above under the heading "Contracts for transfer of property in goods" applies to contracts of hire.

Conclusion

Nature of a bailor's duty and standard of fitness required

5.79 As discussed above, at common law a term as to fitness for purpose will generally be implied, but to what extent it will be implied is unclear as there have been at least three approaches to this question. The consequences differ according to the approach taken. Approach A is strict liability. A bailor of the defective goods will be liable even if the defect could not have been found, however careful and skilful he had been. If Approach C is taken, a bailor will have a defence if he has exercised all reasonable care himself. If Approach B is taken, a bailor might escape liability if he proves that the defect arose without negligence on anybody's part and that the defect was not discoverable by the exercise of reasonable care and skill.[80]

5.80 It must be pointed out that the selection of any one approach determines not only the nature of a bailor's duty (whether it is strict or negligence-based) but also the standard of fitness. Under Approach A, a bailor must ensure that the goods supplied are reasonably fit for the purpose for which they are required, but the goods need not be in perfect condition.[81] If Approach B is adopted, a bailor has to make the goods as fit for use as reasonable skill and care could make them.[82]

5.81 For the following reasons, we recommend Approach A. First, the standard of fitness required under Approach B is arguably higher than that under Approach A[83], requiring a bailor to make the goods as near perfect as is

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80 Law Commission, *Law of Contract, Implied Terms in Contracts for the Supply of Goods*, Working Paper No 71, 1977, at para 57.

81 This could be illustrated by the supply of a second-hand car. A road-worthy second-hand car is of merchantable quality and reasonably fit for the purpose for which it is required even though the car requires some work to be done on it (*Barlett v Sydney Marcus Ltd* [1965] 1 WLR 1013).

82 In the above example of supply of a second-hand car, the supplier has to do all the work required to be done, even though the car is road-worthy without those things having been done.

83 *Vogan & Co v Oulton* [1898] 79 LT 384.

humanly possible,[84] although the liability under Approach B is negligence-based. The Law Commission of England and Wales was of the view that Approach B might occasionally lead to absurd results which could be avoided by adopting Approach A.[85]

5.82 Secondly, as a matter of policy, Approach A is more appropriate as *"it is no consolation to a hirer saddled with a defective article to be told that the defect was not discoverable by reasonable care or skill."*[86]

5.83 Thirdly, Approach A is appropriate for the sake of consistency with other kinds of supply of goods. The liability of a supplier in relation to the fitness and merchantability of goods under a contract of sale (section 16 of Cap 26) is strict (Approach A). Under the heading "Contracts for transfer of property in goods" above, we recommend Approach A. In the absence of any clear justification for a distinction between contracts of sale and contracts for transfer of property in goods on the one hand, and contracts of hire on the other, we recommend imposing a strict liability approach (Approach A) for all types of supply of goods in the Recommended Legislation.

Two obligations: quality and fitness for purpose

5.84 The above cases concerning a bailor's obligations under a contract of hire only mentioned "fitness", but not "merchantability". The Law Commission of England and Wales thought[87] that although the courts did not mention both "merchantability" and "fitness for purpose", one could still regard two obligations as being implied: one as to reasonable fitness for ordinary purposes (very close to merchantability), and the other as to fitness for any particular purpose made known to the supplier. Section 16 of Cap 26 implies both obligations as to merchantability and fitness for purpose. For the avoidance of doubt, we recommend spelling out clearly in the Recommended Legislation that for contracts of hire, as in contracts of sale, there are implied terms as to both quality and fitness for purpose.

Condition or warranty

5.85 Although a term as to fitness (and, arguably, merchantability) is implied for a contract of hire under common law, it is not clear whether the implied term is a condition (breach of which entitles a hirer to reject the goods) or a warranty (breach of which entitles a hirer to damages only). The implied terms as to merchantable quality and fitness for a particular purpose under a contract of sale are conditions.[88] We have recommended, under the heading of "Contracts for the transfer of property in goods", that terms as to quality and fitness for purpose to be implied for contracts for the transfer of property in

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84 Law Commission, *Law of Contract, Implied Terms in Contracts for the Supply of Goods*, Working Paper No 71, 1977, at para 58.

85 Law Com WP No 71, at para 58.

86 RM Goode, *Hire-Purchase Law and Practice*, 2nd Ed,1970, at p 235.

87 Law Com WP No 71 para 62; Law Com No 95.

88 Cap 26, s16. In England and Wales, the implied terms under contracts of hire follow the sale of goods model and so the implied terms as to quality and fitness are also conditions: the 1982 Act, s4, as amended by the Sale and Supply of Goods Act 1994.

goods should be conditions. We recommend above that the implied terms for a contract of hire are to follow those for a contract of sale and also be consistent with other types of supply of goods. Accordingly, we also recommend that the implied terms as to quality and fitness for a contract of hire should be conditions for the sake of consistency.

Defects made known to the hirer; and "in the course of business"

5.86 The cases show that a bailor is not liable for defects made known to the hirer.[89] A bailor would also not be liable for unfitness of the goods for a particular purpose where the hirer either did not make the required purpose known or did not rely on the bailor's skill or judgment.[90] The common law position on this is in line with section 16 of Cap 26.

5.87 In all the cases discussed earlier under the heading "Common law position in Hong Kong", the goods were supplied in the course of the bailor's business. *Hyman v Nye*[91] can be regarded as supporting the proposition that the terms as to quality and fitness for purpose will be implied where goods are supplied to a hirer in the course of business.

Experiences of other jurisdictions

5.88 As discussed under the heading "Contracts for transfer of property in goods", the differences between section 16 of Cap 26 and the equivalent statutory implied terms for other kinds of supply of goods in other jurisdictions shed some light on how we should formulate the implied terms as to quality and fitness for other kinds of supply of goods in the Recommended Legislation. To summarise the recommendations again:

(a) the reasonable man test should be adopted for "quality";

(b) the list of aspects of "quality" should be non-exhaustive;

(c) in the list of aspects of "quality", the goods are required to be fit for all their common purposes;

(d) the term "satisfactory quality" should replace "merchantable quality";

(e) "state or condition" should be put together with the list of aspects of "quality" in the same sub-section;

(f) the concept of "antecedent negotiation" in section 16(6) of Cap 26 should be followed.

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89 *Jones v Page* [1867] 15 LT (NS) 619.

90 *Hyman v Nye* [1881] 6 QBD 685.

91 [1881] 6 QBD 685. At p 687-688, Lindley J stated, *"[n]or does it appear to me to be at all unreasonable to exact such vigilance from a person who makes it his business to let out carriages for hire".* At p 689-690, Mathew J stated, *"…trust is reposed in the person who, in the ordinary course of business, sells or lets to hire*".

Recommendation 13

We recommend that implied terms about quality and fitness similar to those in section 16 of Cap 26 be enacted for both consumer and non-consumer contracts of hire with some appropriate amendments, namely:

(a) (i) where a bailor hires out goods in the course of a business, there should be an implied condition that the goods supplied are of satisfactory quality except:

- **the defects which have been specifically drawn to the bailee's attention before the contract;**
- **where the bailee examines the goods before the contract, the defects which ought to have been revealed by that examination; or**
- **where the contract is one by reference to a sample, the defects which would have been apparent on a reasonable examination of the sample;**

(ii) the test of "satisfactory quality" should be the standard of a reasonable person who regards the goods as satisfactory, taking account of their description, the consideration for the supply of goods and other relevant circumstances;

(iii) the inclusion of "state or condition" should be put together, in the same sub-section, with the list of aspects of "quality", which should be non-exhaustive;

(iv) in the list of aspects of "quality", goods are required to be fit for all their common purposes;

(b) (i) where a bailor hires out goods in the course of a business, and the bailee expressly or impliedly makes known to the bailor (or any person who conducts any antecedent negotiations), any particular purpose for acquiring the goods, there should be an implied condition that the goods are reasonably fit for that purpose except where:

- **the bailee does not rely; or**
- **it is unreasonable for him to rely,**

on the skill or judgment of the bailor or the person who conducted the antecedent negotiations;

(ii) "antecedent negotiations" means any negotiations or arrangements with a bailee whereby he was induced to make the agreement or which otherwise promoted the transaction;

(c) the implied condition or warranty as to quality or fitness for a particular purpose may be annexed to a contract by usage;

(d) the foregoing provisions should apply to a bailment of goods by a person who in the course of a business is acting as agent for another in the same way that they apply to a bailment by a principal in the course of a business, except where:

- **that other is not bailing goods in the course of a business; and**
- **the bailee knows this, or reasonable steps have been taken to let the bailee know this before the contract;**

(e) the notion of "caveat emptor" should be preserved to the extent by limiting the application of the implied condition or warranty as to quality and fitness for a particular purpose to bailments "in the course of a business", "bailments by sample" and other situations provided in other enactments.

Hire Purchase Agreements

Common law position in Hong Kong

Implied term as to quality

5.89 At common law, there is no authority on whether under a hire purchase agreement there is an implied term as to quality. Professor R M Goode[92] believes that there is *"no reason why such a term should not be implied"* since a hirer's position has been equated with that of a buyer in respect of other implied terms, namely, title, correspondence with description, quiet enjoyment, etc. Professor Aubrey Diamond has also found it difficult to *"see why there should not be such a term at common law".*[93]

Implied term as to fitness for purpose

5.90 At common law, where a hirer, expressly or by implication, makes known to the bailor any particular purpose for which the hirer requires the goods, so as to show that the hirer relies on the bailor's skill and judgment,[94] there is an implied term as to fitness for purpose.[95] The particular purpose must be pointed out to the bailor before or at the time of the making of the agreement.[96] It appears that there is no requirement for a bailor to supply the goods in the course of his business. There is no direct decision on this, but in *Astley Industrial Trust Ltd v Grimley*[97] it seems to have been assumed that it is sufficient for a hirer to show his reliance on a bailor's skill and judgment.

(a) nature of a bailor's liability and standard of fitness required

5.91 As to the nature of a bailor's liability and standard of fitness required, the above discussion on the common law position in Hong Kong under the heading "Contracts of hire" is relevant to hire purchase agreements. In some hire purchase cases, Approach A was favoured,[98] while Approach B was favoured in others.[99] Professor Diamond pointed out that it was not *"at all*

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92 R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 241.

93 A L Diamond, *Introduction to Hire-Purchase Law*, 2nd Ed, 1971, at p 57.

94 The hirer's reliance on the skill and judgment of the person letting the goods on hire purchase must be shown. Therefore, if the hirer hires the goods from a finance company which has no contact with him before the agreement, and all the discussions relating to the goods are between the hirer and the dealer, it would be difficult for the hirer to prove his reliance on the bailor's (finance company) skill and judgment. Reliance on the skill and judgment of the dealer will not suffice. *Beaton v Moore Acceptance Corporation (*1959), 33 ALJR 345.

95 *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584; *Yeoman Credit, Ltd v Apps* [1962] 2 QB 508.

96 *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584.

97 [1963] 1 WLR 584. See RM Goode, *Hire-Purchase Law and Practice*, 2nd Ed, 1970, at p 230 and n14.

98 Parker LJ in *Karsales (Harrow), Ltd v Wallis,* [1956] 2 All ER 866 said, *"it is the duty of a hire-purchase finance company …to ascertain that the chattel is reasonably fit for the purpose for which it is expressly hired"* at p 943.

99 Upjohn LJ in *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584 said, *"[t]he second implied stipulation is that the [chattel] must be as fit for the purpose for which it is hired as reasonable*

clear … that the judges in question had their attention directed to the significant difference between sale and hire in this connection". As in contracts of hire, the position concerning hire purchase agreements is therefore not clear.

(b) condition or warranty

5.92 The implied term as to fitness for a particular purpose used to be regarded as a condition in a hire purchase agreement, the breach of which entitled a hirer to terminate the agreement.[100] Subsequently, the court[101] has emphasised the dangers of polarising a contractual term as either a condition or a warranty. Upjohn LJ expressed his opinion on the implied term of fitness in a hire purchase agreement in *Astley Industrial Trust Ltd v Grimley*[102]

> *"I would regard this not as a condition going to the root of the contract but as a stipulation in the nature of a warranty . …"*[103]

Australia

5.93 For consumer hire purchase agreements, there are implied conditions as to quality and fitness for purpose in section 71 of the 1974 Act, since "supply" is defined in section 4 to include "hire purchase". The discussion above under the heading "Contracts for transfer of property in goods" therefore applies to hire purchase agreements.

5.94 For non-consumer hire purchase agreements, there are implied conditions that the goods are of merchantable quality,[104] and are reasonably fit for such purposes as have been made known to an owner expressly or by implication.[105]

New Zealand

5.95 For consumer hire purchase agreements, there are guarantees as to quality and fitness for purpose in sections 6-8 of the 1993 Act, since "supply" is defined in section 2 to include "hire purchase". The discussion above under the heading "Contracts for transfer of property in goods" also applies to hire purchase agreements.

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skill and care can make it" at p 598.

100 RM Goode, *Hire-Purchase Law and Practice*, 2nd Ed,1970, at p 236.

101 *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha, Ltd* [1962] 2 QB 26.

102 [1963] 1 WLR 584.

103 [1963]1 WLR 584 at p 598. However, the Court of Appeal held that on the facts of the case, the bailor had excluded its liability by the terms of the contract.

104 (QLD) Hire-Purchase Act 1959 s5(2); (TAS) Hire-Purchase Act 1959 s9(2); (VIC) Hire-Purchase Act 1959 s5(2); (WA) Hire-Purchase Act 1959 s5(2).

105 (QLD) Hire-Purchase Act 1959 s5(3); (TAS) Hire-Purchase Act 1959 s9(3); (VIC) Hire-Purchase Act 1959 s5(3); (WA) Hire-Purchase Act 1959 s5(3).

5.96 For non-consumer hire purchase agreements, sections 12 and 13 of the Hire Purchase Act 1971 provide similar guarantees as to quality and fitness for purpose.

England and Wales

5.97 Section 10 of the 1973 Act provides for the implied terms as to quality and fitness for purpose. It reads as follows:

> *"(1) Except as provided by this section and section 11 below and subject to the provisions of any other enactment, including any enactment of the Parliament of Northern Ireland or the Northern Ireland Assembly, there is no implied term as to the quality or fitness for any particular purpose of goods bailed or (in Scotland) hired under a hire-purchase agreement.*
>
> *(2) Where the creditor bails or hires goods under a hire-purchase agreement in the course of a business, there is an implied term that the goods supplied under the agreement are of satisfactory quality.*
>
> *(2A) For the purposes of this Act, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.*
>
> *(2B) For the purposes of this Act, the quality of goods includes their state and condition and the following (among others) are in appropriate cases aspects of the quality of goods –*
>
> *(a) fitness for all the purposes for which goods of the kind in question are commonly supplied,*
> *(b) appearance and finish,*
> *(c) freedom from minor defects,*
> *(d) safety, and*
> *(e) durability.*
>
> *(2C) The term implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory –*
>
> *(a) which is specifically drawn to the attention of the person to whom the goods are bailed or hired before the agreement is made,*

(b) where that person examines the goods before the agreement is made, which that examination ought to reveal, or

(c) where the goods are bailed or hired by reference to a sample, which would have been apparent on a reasonable examination of the sample;

(3) Where the creditor bails or hires goods under a hire-purchase agreement in the course of a business and the person to whom the goods are bailed or hired, expressly or by implication, makes known –

(a) to the creditor in the course of negotiations conducted by the creditor in relation to the making of the hire-purchase agreement, or

(b) to a credit-broker in the course of negotiations conducted by that broker in relation to goods sold by him to the creditor before forming the subject matter of the hire-purchase agreement,

any particular purpose for which the goods are being bailed or hired, there is an implied term that the goods supplied under the agreement are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the person to whom the goods are bailed or hired does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the creditor or credit-broker.

(4) An implied term as to quality or fitness for a particular purpose may be annexed to a hire-purchase agreement by usage.

(5) The preceding provisions of this section apply to a hire-purchase agreement made by a person who in the course of a business is acting as agent for the creditor as they apply to an agreement made by the creditor in the course of a business, except where the creditor is not bailing or hiring in the course of a business and either the person to whom the goods are bailed or hired knows that fact or reasonable steps are taken to bring it to the notice of that person before the agreement is made.

(6) In subsection (3) above and this subsection –

(a) 'credit-broker' means a person acting in the course of a business of credit brokerage;

(b) 'credit brokerage' means the effecting of introductions of individuals desiring to obtain credit –

(i) to persons carrying on any business so far as it relates to the provision of credit, or

(ii) to other persons engaged in credit brokerage.

(7) As regards England and Wales and Northern Ireland, the terms implied by subsections (2) and (3) above are conditions."

5.98 As with contracts for the transfer of property in goods, there are implied conditions as to quality and fitness for purpose in both consumer and non-consumer hire purchase agreements. Section 10 of the 1973 Act is similar to sections 4 and 9 of the 1982 Act, and so the discussion above under the heading "Contracts for transfer of property in goods" applies to hire purchase agreements.

Conclusion

Implied term as to quality

5.99 Although there is no direct authority at common law, academics have suggested that an implied term as to quality should be implied at common law for a hire purchase agreement. As discussed above, there is such an implied term for contracts of sale in Cap 26, and in other jurisdictions for hire purchase agreements. Therefore, we recommend that such a term be implied for hire purchase agreements and be set out clearly in the Recommended Legislation for the sake of certainty, clarity and consistency with contracts of sale under Cap 26 and other types of contracts for the supply of goods.

Implied term as to fitness for purpose

5.100 At common law, such a term is implied for hire purchase agreements, but its nature and extent are not clear. For the following reasons, we recommend that strict liability applies so as to remove any doubt. First, the common law position is not clear and it is necessary to clarify it in the Recommended Legislation. Secondly, as discussed above concerning contracts of hire, adopting Approach B may lead to some absurdity which can be avoided by adopting Approach A. Thirdly, academics generally favour Approach A.[106] Fourthly, Approach A is preferred also for the sake of

[106] Professor Diamond has said, "*it is submitted that as hire-purchase has a greater resemblance to sale than to hire the implied term ought to follow that under s14(1) of the Sale of Goods Act*" in his *Introduction to Hire-Purchase Law*, 2nd Ed, 1971, at p 57. As a matter of policy, strict liability is also preferred by Professor Goode as "*it is no consolation to a hirer saddled with a*

consistency with contracts of sale under Cap 26 and other types of supply of goods as recommended above.

5.101 We also recommend that the term should be made a condition in the Recommended Legislation to offer more protection to hirers, and for the consistency with contracts of sale and other types of contracts for the supply of goods. Moreover, for the consistency with other kinds of contracts for the supply of goods and for the avoidance of doubt, a hirer must show that the bailor supplies the goods in the course of his business. This is also in line with the provisions of other jurisdictions examined above concerning hire purchase agreements.

Experience from other jurisdictions

5.102 As discussed under the heading "Contracts for transfer of property in goods", the differences between section 16 of Cap 26 and the equivalent statutory implied terms for other kinds of supply of goods in other jurisdictions indicate how we should formulate the implied terms as to quality and fitness for other kinds of supply of goods in the Recommended Legislation. To summarise the recommendations again:

(a) the reasonable man test should be adopted for "quality";

(b) the list of aspects of "quality" should be non-exhaustive;

(c) in the list of aspects of "quality", goods are required to be fit for all their common purposes;

(d) the term "satisfactory quality" should replace "merchantable quality";

(e) "state or condition" should be put together with the list of aspects of "quality" in the same sub-section;

(f) the concept of "antecedent negotiation" in section 16(6) of Cap 26 should be followed.

Recommendation 14

We recommend that implied terms about quality and fitness similar to those in section 16 of Cap 26 should be enacted for both consumer and non-consumer hire purchase agreements with some appropriate amendments, namely:

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defective article to be told that the defect was not discoverable by reasonable care or skill." See R M Goode, *Hire-Purchase Law and Practice*, 2nd Ed,1970, at p 235.

(a) (i) where a bailor hires out goods in the course of a business, there should be an implied condition that the goods supplied are of satisfactory quality except:

- **the defects which have been specifically drawn to the bailee's attention before the agreement;**

- **where the bailee examines the goods before the agreement, the defects which ought to have been revealed by that examination; or**

- **where the agreement is one by reference to a sample, the defects which would have been apparent on a reasonable examination of the sample;**

(ii) the test of "satisfactory quality" should be the standard of a reasonable person who regards the goods as satisfactory, taking account of their description, the consideration for the supply of goods and other relevant circumstances;

(iii) the inclusion of "state or condition" should be put together, in the same sub-section, with the list of aspects of "quality", which should be non-exhaustive;

(iv) in the list of aspects of "quality", the goods are required to be fit for all their common purposes;

(b) (i) where a bailor hires out goods in the course of a business, and the bailee expressly or by implication makes known to the bailor (or any person who conducts any antecedent negotiations), any particular purpose for acquiring the goods, there should be an implied condition that the goods are reasonably fit for that purpose except where:

- **the bailee does not rely; or**

- **it is unreasonable for him to rely,**

on the skill or judgment of the bailor or the person who conducted the antecedent negotiations;

(ii) "antecedent negotiations" means any negotiations or arrangements with a bailee whereby he was induced to make the agreement or which otherwise promoted the transaction;

(c) the implied condition or warranty as to quality or fitness for a particular purpose may be annexed to an agreement by usage;

(d) the foregoing provisions should apply to a bailment of goods by a person who in the course of a business is acting as agent for another in the same way that they apply to a bailment by a principal in the course of a business, except where:

- that other is not bailing goods in the course of a business;

- the bailee knows this, or reasonable steps have been taken to let the bailee know this before the agreement;

(e) the notion of "caveat emptor" should be preserved to the extent by limiting the application of the implied condition or warranty as to quality and fitness for a particular purpose to bailments "in the course of a business", "bailments by sample" and other situations provided in other enactments.

Chapter 6

Implied terms to be included in the Recommended Legislation – supply by sample

Overview

6.1 In this chapter, we first examine the implied term as to supply by sample in section 17 of the Sale of Goods Ordinance (Cap 26). Then, in respect of this implied term, we examine the three types of contracts for supply of goods recommended in Chapter 2, namely contracts for transfer of property in goods, contracts of hire and hire purchase agreements.

6.2 For each of these three types of contracts, we first examine the common law position in Hong Kong and then the position in Australia, New Zealand and England and Wales. We also examine the relevant comments of academics and overseas law reform bodies.

6.3 We then make recommendations for each of the three types of contracts as follows:

(a) contracts for transfer of property in goods – **Recommendation 15**;
(b) contracts of hire – **Recommendation 16**; and
(c) hire purchase agreements – **Recommendation 17**.

Correspondence with sample under Cap 26

6.4 The undertakings as to correspondence with sample are set out in section 17 of Cap 26 as follows:

> *"(1) A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect.*
>
> *(2) In the case of a contract for sale by sample –*
>
> *(a) there is an implied condition that the bulk shall correspond with the sample in quality;*

(b) there is an implied condition that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(c) there is an implied condition that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample."

6.5 In a contract for the sale of goods by sample, there is an implied *condition* under section 17 that the goods will correspond with the sample in quality and will be free from any defect making them unmerchantable which would not be apparent on reasonable examination of the sample. There is also an implied *condition* that the buyer shall have a reasonable opportunity of comparing the bulk with the sample.[1]

Contracts for the transfer of property in goods

Common law position in Hong Kong

6.6 As discussed in Chapter 3 on "Implied terms about title", in contracts of barter the terms to be implied at common law would be similar to those implied for a contract of sale by Cap 26 in its original version.

6.7 Also as discussed in Chapter 3, it is clear from both *Dodd and Dodd v Wilson and McWilliam*[2] and *Young & Marten Ltd v McManus Childs Ltd*[3] that the terms implied in a contract for work and materials are, so far as the materials are concerned, no less stringent than those implied in a contract of sale.

6.8 Therefore, at common law, there should be an implied term as to supply by sample, similar to that for contracts of sale, for contracts of barter, contracts for work and materials and, in general, for contracts for the transfer of property in goods.

Australia

6.9 The implied term as to supply by sample provided in section 72 of the 1974 Act reads as follows:

"Where in a contract for the supply (otherwise than by way of sale by auction) by a corporation in the course of a business of

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1 S17(2)(b). Section 15(2)(b) of the 1979 Act, which corresponds to paragraph (b) of section 17(2), has been repealed by the Sale and Supply of Goods Act 1994 because section 35 of the Act has been substantially amended to set out a buyer's right to examination before acceptance. Amendments similar to those in the new section 35 of the 1979 Act have been made to section 37 of Cap 26 but section 17(2)(b) has not been repealed.

2 [1946] 2 All ER 691.

3 [1969] 1 AC 454.

goods to a consumer there is a term in the contract, expressed or implied, to the effect that the goods are supplied by reference to a sample:

(a) there is an implied condition that the bulk will correspond with the sample in quality;

(b) there is an implied condition that the consumer will have a reasonable opportunity of comparing the bulk with the sample; and

(c) there is an implied condition that the goods will be free from any defect, rendering them unmerchantable, that would not be apparent on reasonable examination of the sample."

6.10 This implied term applies to all kinds of supply of goods as defined in section 4 which includes barter but not contracts for work and materials.[4] This implied term only operates where there is an express or implied term in the contract that the goods are supplied by reference to a sample. The mere fact that a customer has been shown a sample before the contract is not sufficient.[5] This implied term only applies where the goods are supplied "in the course of a business".[6]

6.11 As the 1974 Act only applies to consumer transactions, the implied term as to supply by sample applies to consumer transactions only. Non-consumer transactions of supply of goods are governed by common law. Although no direct authority can be found on this for barter, the Australian court may follow the views of Blackburn[7] and Chalmers[8] to the effect that the common law obligations of a seller apply to a supplier of a contract of barter. Similarly, no direct authority can be found on supply by sample in contracts for work and materials. But terms as to fitness for purpose and good quality are implied for this type of contract.[9] It would seem reasonable to suppose that the Australian court would also imply a term as to supply by sample similar to that implied for a sale of goods contract.

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4 As mentioned in Chapter 2, section 74 separately provides for some implied terms for contracts for work and materials. But it does not provide for the implied term as to supply by sample. See Chapter 5 for the text of section 74.

5 *L G Thorne & Co Pty Ltd v Thomas Borthwick & Sons (Asia) Ltd* (1956) SR (NSW) 81 at p 87 per Street CJ. It must be shown that the sample was produced as a warranty that the bulk of the goods would correspond with it, and not just to enable the consumer to form a reasonable judgment about the goods. *R W Cameron and Co v Slutzkin Pty Ltd* (1923) 32 CLR 81 at p 89 per Isaacs J.

6 According to *Halsbury's Laws of Australia,* "*English authorities, concerned with analogous legislation, suggest that this expression conveys the concept of some degree of regularity, and the sporadic sale by a corporation of superseded items of capital equipment does not meet this test: Davies v Sumner* [1984] 3 All ER 831"; see *Halsbury's Laws of Australia*, vol 5 [100-650] note 1.

7 Lord Blackburn, *Blackburn's Contract of Sale,* 3rd Ed, 1910, at p ix.

8 Michael Mark, *Chalmers Sale of Goods,* 18th Ed, 1981, at p 82-83.

9 *Halsbury's Laws of Australia*, para 40-415, note 1; para 110-2165, notes 8-9. *G H Myers & Co v Brent Cross Service Co* [1934] 1 KB 46; *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454.

New Zealand

6.12 The implied term as to supply by sample is provided in section 10 of the 1993 Act which reads as follows:

> *"(1) Subject to section 41 of this Act, the following guarantees apply where goods are supplied to a consumer by reference to a sample or demonstration model:*
>
> *(a) That the goods correspond with the sample or demonstration model in quality; and*
>
> *(b) That the consumer will have a reasonable opportunity to compare the goods with the sample.*
>
> *(2) If the goods are supplied by reference to a sample or demonstration model as well as by description, the guarantees in this section and section 9 of this Act will both apply.*
>
> *(3) Part II of this Act gives the consumer a right of redress against the supplier where the goods fail to comply with any guarantee in this section."*

6.13 This implied term applies to all kinds of supply of goods as defined in section 2 and it therefore applies to barter, and contracts for work and materials by virtue of section 15. The implied guarantees are that the goods will correspond in quality with the sample or demonstration model if it is a supply by reference to a sample or demonstration model, and a consumer will have a chance to compare the goods with the sample or model. If the goods are supplied by reference to a sample or demonstration model as well as by description, the goods should correspond with the sample or model as well as the description. These implied guarantees only apply where the goods are supplied in trade (section 41), which is defined in section 2(1).

6.14 As the 1993 Act only applies to consumer transactions, non-consumer contracts for transfer of property in goods are governed by common law. The law relating to barter is undeveloped in New Zealand. The court "*seems inclined to deal with such contracts as if they were analogous to contracts of sale*".[10] As to contracts for work and materials, there is no direct authority as to implication of a term relating to supply by sample. Since terms as to fitness for purpose and good quality are implied,[11] one might expect the New Zealand court to imply a term as to supply by sample similar to that implied for a sale of goods contract.

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10 *The Laws of New Zealand*, Vol 23 at para 54 and note 7.

11 *The Laws of New Zealand*, Vol 2 at para 74. *Batchelor's Pram House Ltd v Mckenzie Brothers Electrical Ltd* [1962] NZLR 545.

England and Wales

6.15 The implied term as to supply by sample is provided in section 5 of the 1982 Act. It reads as follows:

> *"(1) This section applies where, under a contract for the transfer of goods, the transferor transfers or agrees to transfer the property in the goods by reference to a sample.*
>
> *(2) In such a case there is an implied condition –*
>
> *(a) that the bulk will correspond with the sample in quality; and*
>
> *(b) that the transferee will have a reasonable opportunity of comparing the bulk with the sample; and*
>
> *(c) that the goods will be free from any defect, making their quality unsatisfactory which would not be apparent on reasonable examination of the sample.*
>
> *(3) Repealed*
>
> *(4) For the purposes of this section a transferor transfers or agrees to transfer the property in goods by reference to a sample where there is an express or implied term to that effect in the contract concerned."*

6.16 Section 5 is similar to section 15 of the 1979 Act of England and Wales and section 17 of Cap 26. To be a transfer by sample, according to section 5(4), there must be an express or implied term to that effect in the contract. There is no need for the transfer to be made in the course of a business. If there is a transfer by sample, the conditions in subsection (2) will be implied. As to the implied condition of correspondence with the sample in quality, strict compliance is required[12] and correspondence or not depends on the normal trade practice of the nature of the examination carried out.[13]

6.17 In respect of the implied condition of "satisfactory quality", the transferee cannot complain of defects making the quality of the goods unsatisfactory which a reasonable examination of the sample ought to reveal (subsection (2)(c)). In other words, a transferee by sample can complain only

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12 In *E and S Ruben Ltd v Faine Bros and Co Ltd* [1949] 1 KB 254 (a sale of goods case), the buyers were held entitled to reject rolls of rubber which, not corresponding with the sample, were crinkly and hard. It was held irrelevant that the rubber, by a simple process of warming, could be made to correspond with the sample.

13 According to *Hookway & Co v Alfred Isaacs and Sons* [1954] 1 Lloyd's Rep 491, if the normal trade practice is for a sample to be subjected to visual examination only, there is no breach of the implied condition if the non-correspondence is not discoverable by such visual examination.

of latent defects which a reasonable examination cannot reveal. The term "unsatisfactory" shall be construed in light of the term "satisfactory" discussed in Chapter 5 on "Implied terms about quality or fitness".

Conclusion

Similarity among various jurisdictions

6.18 From the above discussion, it is clear that in other jurisdictions there are also implied terms as to supply by sample for either contracts of barter and contracts for work and materials in particular, or contracts for transfer of property in goods in general. The provisions in those other jurisdictions, especially section 5 of the 1982 Act of England and Wales, are similar to the corresponding section 17 of Cap 26 and can provide a blueprint for other types of contracts for the supply of goods in the Recommended Legislation.

Implied condition as to "quality"

6.19 One point worth mentioning is that the implied condition as to "quality" in section 17(2)(c) of Cap 26 means that a buyer (transferee/consumer[14]) by sample can complain only of defects which a reasonable examination of the sample cannot reveal. On the other hand, a buyer (transferee/consumer[15]) not by sample, by relying on the general requirement as to quality in section 16 of Cap 26, can complain of any defects except those which his actual examination ought to reveal. It must be noted that a buyer (transferee) by sample cannot rely on the general "quality" provision in section 16 of Cap 26 (section 4 of the 1982 Act) as he is barred from doing so by section 16(2)(c) of Cap 26 (section 4(3)(c) of the 1982 Act).[16]

6.20 This means that a buyer (transferee/consumer) by sample cannot complain of defects which a reasonable examination of the sample can reveal (the "reasonable examination of the sample" test), even though he has not actually examined the sample. A buyer (transferee/consumer) not by sample, on the other hand, can rely on the general "quality" provision. The "reasonable examination of the sample" test is irrelevant. Only when he has actually examined the sample would whether that examination can reveal the defects become relevant. An academic writer has suggested that[17] this less generous treatment for buyers (transferees) by sample is not unreasonable *"because it can surely be expected that the sample should be examined".* In a transfer by sample, it is fair to expect a transferee to examine the sample. If the defect is not apparent on a reasonable examination of the sample, the transferee is protected by the implied condition as to supply by sample.

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14 There are equivalent provisions in section 5(2)(c) of the 1982 Act of England and Wales (transferee) and section 72(c) of the Australian 1974 Act (consumers), but there is no equivalent provision in the New Zealand 1993 Act.

15 There are equivalent provisions in section 4 of the 1982 Act and section 71 of the 1974 Act.

16 There is no equivalent debarring provision in the 1974 Act.

17 Iwan Davies, *Sale and Supply of Goods*, 2nd Ed, 1996.

Therefore, we recommend that the implied condition as to "quality" in section 17(2)(c) of Cap 26 should be followed for other types of contracts for the supply of goods in the Recommended Legislation.

The term "unmerchantable"

6.21 The term "unmerchantable" is used in both section 17 of Cap 26 and section 72 of the Australia 1974 Act, while "unsatisfactory" is used in section 5 of the 1982 Act of England and Wales. The change from "merchantable" to "satisfactory" was discussed in Chapter 5 under "Implied terms about quality or fitness". Since we have recommended the change to "satisfactory" there, we recommend the same change in this chapter.

Recommendation 15

We recommend that:

(a) a contract for transfer of the property in goods by sample is one where there is an express or implied term in the contract to that effect;

(b) in both consumer and non-consumer contracts for transfer of the property in goods by sample, implied conditions similar to those in section 17 of Cap 26 should be provided, namely:

(i) that the bulk shall correspond with the sample in quality;

(ii) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;

(iii) that the goods shall be free from any defect, rendering them unsatisfactory, which is not apparent on reasonable examination of the sample.

Contracts of hire

Common law position in Hong Kong

6.22 There is little case law on the implied term as to hire by sample, but there is some support for the proposition that implied terms similar to

those in contracts for the sale of goods should apply. The position remains unclear, however.[18]

Australia

6.23 For consumer contracts of hire, an implied condition as to hire by sample is provided in section 72 of the 1974 Act, since "supply" is defined in section 4 to include "hire". The discussion above under the heading "Contracts for transfer of property in goods" also applies to contracts of hire.

6.24 For non-consumer contracts of hire, in Victoria, where a bailor bails goods by sample, there is an implied condition that the goods will correspond with the sample.[19]

New Zealand

6.25 The implied guarantee as to hire by sample in section 10 of the 1993 Act applies to consumer contracts of hire, since "supply" is defined in section 2 to include "hire". The discussion under the heading "Contracts for transfer of property in goods" therefore applies to contracts of hire.

6.26 For non-consumer contracts of hire, there is no direct case law, even though there is an implied warranty that a hirer will enjoy quiet possession for the period of hire.[20]

England and Wales

6.27 The implied term as to hire by sample is provided in section 10 of the 1982 Act as follows:

> *"(1) This section applies where, under a contract for the hire of goods, the bailor bails or agrees to bail the goods by reference to a sample.*

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18 See *Astley Industrial Trust Ltd v Grimley* [1963] 1 WLR 584, a hire-purchase case, per Pearson L J at p 595, Upjohn l J at p 597 and Ormerod L J at p 600; *Reardon Smith Line Ltd v YngvarHansen-Tangen* [1976] 1 WLR 989, per Viscount Dilhorne, at p 1000.
In England and Wales, on consultation, there was general support for the view of the Law Commission that the terms implied at common law as regards correspondence to description and sample should substantially be the same as the terms implied by statute in contracts for sale. See Law Commission, Report on *Implied Terms in Contracts for the Supply of Goods*, Law Com No 95, 1979, at para 86.

19 (Vic) Goods Act 1958 s104. However, in the Northern Territory, South Australia and Western Australia, such an implied condition is implied into consumer contracts only: (NT) Consumer Affairs and Fair Trading Act 1990 s63; (SA) Consumer Transactions Act 1972 s8(3); (WA) Fair Trading Act 1987 s37. There is no equivalent provision in other jurisdictions.

20 *The Laws of New Zealand*, "Bailment", at para 58.

(2) In such a case there is an implied condition –

(a) that the bulk will correspond with the sample in quality; and

(b) that the bailee will have a reasonable opportunity of comparing the bulk with the sample; and

(c) that the goods will be free from any defect, making their quality unsatisfactory, which would not be apparent on reasonable examination of the sample.

(3) Repealed

(4) For the purposes of this section a bailor bails or agrees to bail goods by reference to a sample where there is an express or implied term to that effect in the contract concerned."

6.28 This provision is almost identical to that in section 4 of the same Act concerning contracts for transfer of property in goods. The discussion above under the heading "Contracts for transfer of property in goods" also applies to contracts of hire.

Conclusion

6.29 In Australia, New Zealand and England and Wales there are implied terms as to hire by sample and their provisions are similar to the corresponding section 17 of Cap 26. As discussed above under the heading "Contracts for transfer of property in goods", section 17 of Cap 26 should be the blueprint for other types of contracts for the supply of goods in the Recommended Legislation, and the discussion under that heading should accordingly apply to contracts of hire.

Recommendation 16

We recommend that:

(a) a contract of hire by sample is one where there is an express or implied term in the contract to that effect;

(b) in both consumer and non-consumer contracts of hire by sample, implied conditions similar to those in section 17 of Cap 26 should be provided, namely:

(i) that the bulk shall correspond with the sample in quality;

(ii) that the bailee shall have a reasonable opportunity of comparing the bulk with the sample;

(iii) that the goods shall be free from any defect, rendering them unsatisfactory, which is not apparent on reasonable examination of the sample.

Hire Purchase Agreements

Common law position in Hong Kong

6.30 Where goods are let on hire purchase by reference to a sample, there is no authority on whether there is any implied term as to supply by sample imported to the contract. However, Professor Goode[21] is of the view that it is reasonable to suppose that implied conditions similar to those implied for a contract of sale apply.

Australia

6.31 For consumer hire purchase agreements, an implied condition as to supply by sample is provided in section 72 of the 1974 Act, since "supply" is defined in section 4 to include "hire purchase". The discussion above under the heading "Contracts for transfer of property in goods" applies to hire purchase agreements.

6.32 For non-consumer hire purchase agreements, the position is less clear since there is no statutory implied term in the relevant Hire-Purchase Acts.[22]

New Zealand

6.33 Since "supply" is defined in section 2 to include "hire purchase", the implied guarantee as to supply by sample provided in section 10 of the 1993 Act applies to consumer hire purchase agreements. The discussion under the heading "Contracts for transfer of property in goods" applies to hire purchase agreements.

6.34 For non-consumer hire purchase agreements, section 14(1) of the Hire Purchase Act 1971 provides similar guarantees.

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21 R M Goode, *Hire-Purchase Law and Practice,* 2nd Ed, 1970, at p 218.

22 (QLD) Hire-Purchase Act 1959; (TAS) Hire-Purchase Act 1959; (VIC) Hire-Purchase Act 1959; (WA) Hire-Purchase Act 1959.

England and Wales

6.35 The implied term as to supply by sample is provided in section 11 of the 1973 Act as follows:

> *"(1) Where under a hire-purchase agreement goods are bailed or (in Scotland) hired by reference to a sample, there is an implied term –*
>
> *(a) that the bulk will correspond with the sample in quality; and*
>
> *(b) that the person to whom the goods are bailed or hired will have a reasonable opportunity of comparing the bulk with the sample; and*
>
> *(c) that the goods will be free from any defect making their quality unsatisfactory, which would not be apparent on reasonable examination of the sample.*
>
> *(2) As regards England and Wales and Northern Ireland, the term implied by subsection (1) above is a condition."*

6.36 This provision is almost identical to that in section 4 of the 1982 Act concerning contracts for transfer of property in goods. Therefore, the discussion under the heading "Contracts for transfer of property in goods" applies to hire purchase agreements.

Conclusion

6.37 In Australia, New Zealand and England and Wales there are implied terms as to hire purchase by sample which are similar to those provided in section 17 of Cap 26. As discussed under the heading "Contracts for transfer of property in goods", section 17 of Cap 26 should be the blueprint for other types of contracts for the supply of goods in the Recommended Legislation, and accordingly the discussion under that heading should apply to hire purchase agreements.

Recommendation 17

We recommend that:

(a) a hire purchase by sample is one where there is an express or implied term in the agreement to that effect;

(b) **in both consumer and non-consumer hire purchase by sample, implied conditions similar to those in section 17 of Cap 26 should be provided, namely:**

(i) **that the bulk shall correspond with the sample in quality;**

(ii) **that the bailee shall have a reasonable opportunity of comparing the bulk with the sample;**

(iii) **that the goods shall be free from any defect, rendering them unsatisfactory, which is not apparent on reasonable examination of the sample.**

Chapter 7

Remedies for breaches of the implied terms

OVERVIEW

7.1 In this chapter, we discuss the remedies for breaches of the implied terms in the Recommended Legislation. We first discuss the present position of the remedies for breaches of the implied conditions and warranties in contracts of sale of goods under Cap 26, followed by the case law developments on intermediate/innominate terms and the problems of the statutory distinction between conditions and warranties.

7.2 We also examine the position in Australia, New Zealand and England and Wales. After discussing the relevant issues, we then make recommendations in respect of –

(a) the classification into "conditions" and "warranties" – **Recommendation 18**;

(b) the restriction on non-consumers' rights to reject goods – **Recommendation 19**; and

(c) the definition of "dealing as consumers" – **Recommendation 20.**

Remedies for breaches of implied terms in contracts of sale of goods in Hong Kong

7.3 In the 19th century, contractual obligations were generally thought to fall into two main categories, namely conditions and warranties. The difference between conditions and warranties lies in the difference in remedies available for breaches of them. A breach of a condition entitles the innocent party, if he so chooses, to treat himself as discharged from further performance under the contract, and in any event to claim damages for loss caused by the breach. A breach of warranty does not entitle the innocent party to treat himself as discharged, but to claim damages only.[1]

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[1] *Chitty on Contracts*, 26th Ed, Vol 1, para 787.

Conditions and warranties in contracts of sale of goods

7.4 Cap 26 reflects this distinction. The statutory implied obligations in Cap 26 are categorised into conditions and warranties. In Cap 26, the expression "warranty" is defined in section 2(1) as follows:

> *"'warranty' means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated."*

7.5 The expression "condition" is not directly defined in Cap 26. There is a definition by inference in section 13(2), which reads as follows:

> *"Whether a stipulation in a contract of sale is a condition, the breach of which may give rise to a right to treat the contract as repudiated, or a warranty, the breach of which may give rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated, depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract."*

7.6 The statutory implied terms as to title, quality, fitness for purpose and correspondence with description and sample are all classified as conditions in Cap 26.[2] The statutory implied terms as to freedom from encumbrances and quiet possession are classified as warranties.[3]

7.7 Whether a statutory implied term is a condition or a warranty has a significant effect on a buyer's remedy for its breach. If the term is a condition, a buyer can reject the goods, however unimportant the breach actually is. He can treat the contract as repudiated and recover the price if he has already paid (provided that he has not accepted the goods, or that he has not waived the condition or elected to treat it as a mere breach of warranty). If the term is a warranty, a buyer can only claim damages.

Intermediate/innominate terms – case law developments

7.8 The distinction between conditions and warranties stipulated in Cap 26 means that there is certainty as to the consequences of breaches of statutory implied terms. On the other hand, new principles on the remedies for breaches of contractual terms have arisen from case law concerning both contract laws in general and sale of goods law in particular. In *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*,[4] the English Court of Appeal

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2 Cap 26, sections 14(1)(a), 15, 16(2) and (3), 17(2).
3 Cap 26, section14(1)(b) and (2).
4 [1962] 2 QB 26.

held that the stipulation as to seaworthiness was neither a condition nor a warranty but an intermediate or innominate term. Diplock L J said:

> *"There are, however, many contractual undertakings of a more complex character which cannot be categorised as being 'conditions' or 'warranties' .... Of such undertakings all that can be predicated is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended he should obtain from the contract; and the legal consequences of a breach of such undertaking, unless provided for expressly in the contract, depend upon the nature of the event to which the breach gives rise and do not follow automatically from a prior classification of the undertaking, as a 'condition' or a 'warranty'."*[5]

7.9 Such terms are called "intermediate" or "innominate" terms. The law has to give regard to the nature and gravity of the breach before it becomes possible to say whether the innocent party is entitled to repudiate a contract for a breach of a term of this character.[6] Repudiation is justified if the breach can be regarded as depriving a party of substantially the whole benefit of the contract.

7.10 The test is the same as that for frustration of contract and was applied to a sale of goods case in *Cehave N V v Bremer Handelsgesellschaft m b H*.[7] In that case, an express term that the goods were to be shipped in good condition was broken, but it was held that the circumstances were not sufficiently serious to justify rejection. The court held that the Sale of Goods Act did not exhaustively divide all terms into conditions and warranties and that section 62(2) of the 1893 Act (the equivalent of section 62(2) of Cap 26) preserved the effect of common law rules save insofar as they were inconsistent with the Act.

7.11 These new principles have been approved by the House of Lords in *Reardon Smith Line Ltd v Hansen-Tangen*[8] and in *Bunge Corporation v Tradax Export S A.*[9] Lord Scarman[10] has stated that the statutory classification of terms as conditions and warranties should not *"be treated as an indication that the law knows no terms other than conditions and warranties".* In construing a contract, a term can be classified as a condition, warranty or an innominate term depending on the intention of the parties. If the intention of the parties is clear, a term may be construed as a condition even if the parties do not expressly specify it as a condition.

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5 [1962] 2 QB 26, at p 70.
6 P S Atiyah, *The Sale of Goods*, 9th Ed, at p 58.
7 [1976] QB 44.
8 [1976] 1 WLR 989, per Lord Wilberforce at p 998.
9 [1981] 1 WLR 711.
10 [1981] 1 WLR 711, at p 718.

7.12 It must be pointed out that the *"developments described above have certainly not eliminated the legal type of term known as conditions".*[11] Accordingly, the terms classified as conditions under Cap 26 remain as conditions.[12]

Problems of the statutory distinction between conditions and warranties

7.13 The dichotomy in Cap 26 between a condition (breach of which allows rejection) and a warranty (breach of which does not) provides for certainty as to a buyer's rights, and facilitates quick rejection of goods. However, such a sharp distinction is not without problems.

7.14 First, breaches of some of the statutory implied terms (for example, as to quality) may range from trivial to very serious breaches which render the goods worthless. Replacements or repairs can remedy some breaches easily and quickly. The sharp distinction between conditions and warranties can lead to easy and quick rejection of goods on purely technical grounds, motivated by market factors, especially in non-consumer transactions. This may in some cases be unfair to sellers whose losses far exceed the cost of remedying the breaches.

7.15 Secondly, because of this inflexibility, the easy availability of a right of rejection can sometimes work against the interests of a buyer. Since the remedy of rejection is so powerful, in the case of a trivial breach, the court may be very cautious in allowing rejection, and may simply hold that there is no breach of the statutory implied terms. In such a case, the buyer cannot even recover damages although what has been breached is a condition and the buyer ends up with no remedy at all. This is because the court cannot award damages and at the same time decide that the buyer has no right to reject the goods for a breach of a condition. For example, in *Cehave N V v Bremer Handelsgesellschaft m b H,*[13] Lord Denning M R stated that the implied condition in question was broken only if the defect was so serious that a commercial man would have thought that a buyer should be able to reject the goods. In *Millars of Falkirk Ltd v Turpie,*[14] the court held that there was no breach of the statutory implied condition even though the car delivered was admittedly defective and required repair.

7.16 In addition, Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen,*[15] criticised the inflexibility of the statutory condition as to compliance with description and characterised the cases on it as "excessively technical".

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11 P S Atiyah, *The Sale of Goods*, 9th Ed, at p 60.

12 P S Atiyah, *The Sale of Goods*, 9th Ed, at p 60. *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 10-037.

13 [1976] QB 44, at p 62.

14 1976 SLT (Notes) 66.

15 [1976] 1 WLR 989, per Lord Wilberforce at p 998.

Australia

7.17 Section 75A(1) of the 1974 Act provides a consumer with a right to rescind a contract of supply when there is a breach of a condition implied by Part V Division 2 of the Act (discussed in Chapters 2-6 above). Sub-section (1)(c) & (d) provides for the manner by which a contract of supply may be rescinded. A consumer may rescind a contract by a written notice giving particulars of the breach, or by returning the goods to the supplier and giving particulars of the breach. Section 75A(1) reads as follows:

> "*Where:*
>
> *(a) a corporation supplies goods to a consumer in the course of a business; and*
>
> *(b) there is a breach of a condition that is, by virtue of a provision of Division 2, implied in the contract for the supply of the goods;*
>
> *the consumer is, subject to this section, entitled to rescind the contract by:*
>
> *(c) causing to be served on the corporation a notice in writing signed by him or her giving particulars of the breach; or*
>
> *(d) causing the goods to be returned to the corporation and giving to the corporation, either orally or in writing, particulars of the breach."*

7.18 Sub-section (2) provides that the right to rescind may be lost if, for example, the notice is not served or the goods are not returned within a reasonable time after the consumer has had a reasonable opportunity to inspect the goods. Where the right of rescission is lost, a consumer is restricted to a claim for damages.[16] Sub-section (2) provides as follows:

> *"Where a consumer purports to rescind under this section a contract for the supply of goods by a corporation, the purported rescission does not have any effect if:*
>
> *(a) the notice is not served or the goods are not returned within a reasonable time after the consumer has had a reasonable opportunity of inspecting the goods;*
>
> *(b) in the case of a rescission effected by service of a notice, after the delivery of the goods to the consumer but before the notice is served:*

[16] *Mackay v R J Hobbs Pty Ltd* (1986) ASC 55-466, Fed C of A.

(i) the goods were disposed of by the consumer, were lost, or were destroyed otherwise than by reason of a defect in the goods;

(ii) the consumer caused the goods to become unmerchantable or failed to take reasonable steps to prevent the goods from becoming unmerchantable; or

(iii) the goods were damaged by abnormal use; or

(c) in the case of a rescission effected by return of the goods, while the goods were in the possession of the consumer:

(i) the consumer caused the goods to become unmerchantable or failed to take reasonable steps to prevent the goods from becoming unmerchantable; or

(ii) the goods were damaged by abnormal use."

7.19 Sub-section (3) provides for the effect of rescinding a contract according to this section. Property in the goods re-vests in the supplier and the consumer becomes entitled to recover from the supplier as a debt the amount of any consideration provided for the goods. It must be pointed out that pursuant to sub-section (4), the right of rescission conferred by this section is additional to any other rights a consumer may have. Sub-sections (3) and (4) read as follows:

"*(3) Where a contract for the supply of goods by a corporation to a consumer has been rescinded in accordance with this section:*

(a) if the property in the goods had passed to the consumer before the notice of rescission was served on, or the goods were returned to, the corporation - the property in the goods re-vests in the corporation upon the service of the notice or the return of the goods; and

(b) the consumer may recover from the corporation, as a debt, the amount or value of any consideration paid or provided by him or her for the goods.

(4) The right of rescission conferred by this section is in addition to, and not in derogation of, any other right or remedy under this Act or any other Act, any State Act, any law of a Territory or any rule of law."

7.20 A consumer has a right to rescission only when there is a breach of a condition implied in Part V Division 2. In other words, a consumer only has a claim for damages in respect of a breach of a warranty. A consumer's claim for damages is based on ordinary contract principles.

New Zealand

7.21 Section 16 of the 1993 Act provides a consumer with a right of redress against a supplier where there is a failure to comply with any guarantee in sections 5 to 10. Section 16 provides as follows:

> "*This Part of this Act gives a consumer a right of redress against a supplier of goods where the goods fail to comply with any guarantee set out in any of sections 5 to 10 of this Act."*

Options of remedies available to consumers

7.22 Section 18 provides several remedial options which a consumer may exercise where there is a failure to comply with any guarantee set out in sections 5 to 10. Where the failure can be remedied, a consumer may require the supplier to remedy the failure within a reasonable time (sub-section(2)). If the supplier does not remedy the failure within a reasonable time, the consumer can have the failure remedied elsewhere and obtain from the supplier all reasonable costs incurred, or the consumer can reject the goods. Where the failure cannot be remedied or is of a "substantial character" as defined in section 21, a consumer can reject the goods, or obtain damages for any reduction in value of the goods (sub-section (3)). In addition to the above remedies, a consumer may obtain from the supplier damages for any loss or damage resulting from the failure (sub-section (4)). Section 18 reads as follows:

> "*(1) Where a consumer has a right of redress against the supplier in accordance with this Part of this Act in respect of the failure of any goods to comply with a guarantee, the consumer may exercise the following remedies.*
>
> *(2) Where the failure can be remedied, the consumer may –*
>
> *(a) Require the supplier to remedy the failure within a reasonable time in accordance with section 19 of this Act:*
>
> *(b) Where a supplier who has been required to remedy a failure refuses or neglects to do so, or does not succeed in doing so within a reasonable time, -*

(i) Have the failure remedied elsewhere and obtain from the supplier all reasonable costs incurred in having the failure remedied; or

(ii) Subject to section 20 of this Act, reject the goods in accordance with section 22 of this Act.

(3) Where the failure cannot be remedied or is of a substantial character within the meaning of section 21 of this Act, the consumer may –

(a) Subject to section 20 of this Act, reject the goods in accordance with section 22 of this Act; or

(b) Obtain from the supplier damages in compensation for any reduction in value of the goods below the price paid or payable by the consumer for the goods.

(4) In addition to the remedies set out in subsection (2) and subsection (3) of this section, the consumer may obtain from the supplier damages for any loss or damage to the consumer resulting from the failure (other than loss or damage through reduction in value of the goods) which was reasonably foreseeable as liable to result from the failure."

Definition of the expression "substantial character"

7.23 The expression "substantial character" is defined in section 21 to cover goods which would not have been acquired by a reasonable consumer who was acquainted with the nature of the failure or which depart in substantial respects from the description, sample and demonstration model. The definition also covers goods which are substantially unfit for a general or particular purpose or which are not of acceptable quality because they are unsafe. Section 21 provides as follows:

"*For the purposes of section 18(3) of this Act, a failure to comply with a guarantee is of a substantial character in any case where –*

(a) The goods would not have been acquired by a reasonable consumer fully acquainted with the nature and extent of the failure; or

(b) The goods depart in one or more significant respects from the description by which they were supplied or, where they were supplied by reference to a sample or

demonstration model, from the sample or demonstration model; or

(c) The goods are substantially unfit for a purpose for which goods of the type in question are commonly supplied or, where section 8(1) of this Act applies, the goods are unfit for a particular purpose made known to the supplier or represented by the supplier to be a purpose for which the goods would be fit, and the goods cannot easily and within a reasonable time be remedied to make them fit for such purpose; or

(d) The goods are not of acceptable quality within the meaning of section 7 of this Act because they are unsafe."

Manner of exercising a right to reject the goods

7.24 A consumer can exercise a right to reject the goods by notifying the supplier of the decision and the grounds and (usually) also by returning the goods to the supplier (section 22(1) and (2)). The ownership in the goods re-vests in the supplier upon notification of rejection (section 22(3)). Section 22 reads as follows:

"*(1) The consumer shall exercise the right to reject goods under this Act by notifying the supplier of the decision to reject the goods and of the ground or grounds for rejection.*

(2) Where the consumer exercises the right to reject goods, the consumer shall return the rejected goods to the supplier –

(a) Unless -

(i) Because of the nature of the failure to comply with the guarantee in respect of which the consumer has the right to reject the goods; or

(ii) Because of the size or height or method of attachment -

the goods cannot be returned or removed or transported without significant cost to the consumer, in which case the supplier shall collect the goods at the expense of the supplier; or

(b) Unless the goods have already been returned to, or retrieved by, the supplier.

(3) Where the ownership in the goods has passed to the consumer before the consumer exercises the right of rejection, the ownership in the goods revests in the supplier upon notification of rejection."

Consequences of exercising a right to reject the goods

7.25 Where a consumer exercises a right to reject the goods, he may choose to have a refund of any consideration provided, or goods of the same type and of similar value as a replacement (section 23). Section 23 provides as follows:

"*(1) Where the consumer exercises the right to reject goods, the consumer may choose to have either –*

(a) A refund of any money paid or other consideration provided by the consumer in respect of the rejected goods; or

(b) Goods of the same type and of similar value to replace the rejected goods, where such goods are reasonably available to the supplier as part of the stock of the supplier -

and the supplier shall make provision accordingly.

(2) A refund referred to in subsection (1)(a) of this section means a refund in cash of the money paid or the value of any other consideration provided, or both, as the case may require.

(3) The obligation to refund cannot be satisfied by permitting the consumer to acquire goods from the supplier.

(4) Where a consumer obtains goods to replace rejected goods pursuant to subsection (1)(b) of this section, the replacement goods shall, for the purposes of this Act, be deemed to be supplied by the supplier, and the guarantees and obligations arising under this Act consequent upon a supply of goods to a consumer shall apply to the replacement goods."

Circumstances under which a right to reject is lost

7.26 A consumer may lose his right to reject goods for reasons mentioned in section 20(1). These include a failure to exercise his right of rejection within the "reasonable time" stipulated in section 20(2). Section 20 reads as follows:

> "*(1) The right to reject goods conferred by this Act shall not apply if –*
>
> *(a) The right is not exercised within a reasonable time within the meaning of subsection (2) of this section; or*
>
> *(b) The goods have been disposed of by the consumer, or have been lost or destroyed while in the possession of a person other than the supplier or an agent of the supplier; or*
>
> *(c) The goods were damaged after delivery to the consumer for reasons not related to their state or condition at the time of supply; or*
>
> *(d) The goods have been attached to or incorporated in any real or personal property and they cannot be detached or isolated without damaging them.*
>
> *(2) In subsection (1)(a) of this section, the term 'reasonable time' means a period from the time of supply of the goods in which it would be reasonable to expect the defect to become apparent having regard to -*
>
> *(a) The type of goods;*
>
> *(b) The use to which a consumer is likely to put them;*
>
> *(c) The length of time for which it is reasonable for them to be used;*
>
> *(d) The amount of use to which it is reasonable for them to be put before the defect becomes apparent.*
>
> *(3) This section applies notwithstanding section 37 of the Sale of Goods Act 1908."*

Means by which a supplier may remedy a failure

7.27 Section 19 provides for the means by which a supplier may comply with a requirement to remedy a failure, including repairing, curing any defect in title, replacing with goods of identical type and refunding any consideration provided. Section 19 provides as follows:

> "*(1) A supplier may comply with a requirement to remedy a failure of any goods to comply with a guarantee –*
> *(a) By -*
>
> *(i) Repairing the goods (in any case where the failure does not relate to title); or*
>
> *(ii) Curing any defect in title (in any case where the failure relates to title); or*
>
> *(b) By replacing the goods with goods of identical type; or*
>
> *(c) Where the supplier cannot reasonably be expected to repair the goods, by providing a refund of any money paid or other consideration provided by the consumer in respect of the goods.*
>
> *(2) Where a consumer obtains goods to replace defective goods pursuant to subsection (1) of this section, the replacement goods shall, for the purposes of this Act, be deemed to be supplied by the supplier and the guarantees and obligations arising under this Act consequent upon a supply of goods to a consumer shall apply to the replacement goods.*
>
> *(3) A refund referred to in subsection (1)(c) of this section means a refund in cash of the money paid or the value of any other consideration provided, or both, as the case may require."*

England and Wales

Distinction between conditions and warranties

7.28 The statutory implied terms for hire purchase agreements stipulated in the 1973 Act, and those for contracts for the transfer of property in goods and contracts of hire stipulated in the 1982 Act are either specified as conditions or warranties. The expressions "condition" and "warranty" are not defined in either the 1973 Act or the 1982 Act. The Law Commission, which recommended adopting these two expressions but leaving them

undefined, said that it was likely that the interpretation of these expressions applied under the 1979 Act would be applied to the 1973 and 1982 Acts.[17]

7.29 A customer in a contract for the supply of goods may seek to reject the goods supplied and terminate the contract on the grounds that the supplier has broken one or more of the terms implied by the 1973 Act or 1982 Act. In order to do so, he must, in the same way as a buyer under a contract of sale, show that there is a breach of an implied term that has been classified as a condition under either of these two Acts.

Recommendation of the Law Commission to restrict the rights of non-consumers to reject goods in the case of trivial breaches

7.30 In 1987, the Law Commission revisited the question of classification of statutory implied terms into "conditions" and "warranties".[18] The Commission was aware that the remedies available to a customer[19] for a breach of one of the statutory implied terms depended on whether the term was classified as a condition or warranty. After considering the development of the common law on classification of contract terms, including the cases on intermediate/innominate terms, the Commission stated:

> *"It might be thought that any difficulty with the remedies for breach of the statutory implied terms could be overcome by removing from them the designation 'condition' and simply referring to them as 'terms'. We do not, however, think that this would by itself achieve the desired objective of improving and clarifying the rights of a buyer of defective goods. To do this would be to give no indication, either to the users of the Sale of Goods Act or to the courts, as to what remedies were to flow from breach of one of the terms. Non-lawyers at least must, in our view, have the remedies set out in the Act so that they are not faced with the difficult task of referring to text-books and legal authorities. In addition, if the Act did not set out the regime of remedies, the general law would provide an answer which would be the wrong one. In English law the buyer would only be able to reject the goods if the breach deprived him of substantially the whole benefit which it was the intention of the parties as expressed in the contract that he should obtain as the consideration for performing his undertakings (ie if the contract was frustrated). This would mean that only in a very few cases would the buyer have the right to reject the goods; such a test would amount to something of a reversal of the present policy and, in particular, would place the consumer buyer in far too*

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17 The Commission based their saying on *Halsbury's Laws of England,* 4th Ed, (1979) Vol 9, para 543, n2. See The Law Commission, Report on *Sale and Supply of Goods,* Law Com No 160, 1987, para 2.32.

18 Law Com No 160.

19 He can be a buyer in a contract of sale, a hirer in a contract of hire or a hire purchase agreement, or a transferee in a contract for transfer of property in goods.

weak a position as regards rejection (though his right to damages would be improved) . … We think it is necessary for both English and Scots law that the consequences of breach of the implied terms should be expressly set out in the Act."[20] (emphasis added)

7.31 After consultation, the Law Commission of England and Wales concluded as follows:

"We have therefore decided to recommend the retention of the present law so far as concerns the consumer buyer's right to reject the goods and terminate the contract for breach of the statutory implied terms in sections 13 to 15 of the Sale of Goods Act. In English law this result can best be achieved by retaining the classification of these implied terms as 'conditions' of the contract .... It is important in this context, we think, to bear in mind that contracts for the supply of goods may well contain express terms and other implied terms and that the classification of the statutory implied terms should harmonise with the rest of the law in which they exist."[21]

7.32 The Commission recommended making distinctions between consumer and non-consumer transactions. The distinction was made not by changing the classification of "conditions" and "warranties" but by introducing new provisions restricting the rights of non-consumers to reject goods in the case of trivial breaches. The Commission said:

"The Law Commission's recommendations apply to England and Wales. They are that for the non-consumer the statutory implied quality terms should remain as conditions but that the Act should provide that where the breach is so slight that it would be unreasonable for the buyer to reject the goods, the breach is not to be treated as a breach of condition but may be treated as a breach of warranty. The effect of this will be that the buyer will not be able to reject the goods but will only be able to claim damages. Use of this technique should help to make it clear that the modification of the right to reject is not intended as a major alteration in the law but one which will apply only where the breach is slight and it is unreasonable for the buyer to reject the goods."[22]

7.33 The Commission recommended the same for other contracts for the supply of goods.[23]

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20 The Law Commission, *Sale and Supply of Goods,* Working Paper No 85, 1983, at para 4.30.

21 Law Com No 160, at para 4.15.

22 Law Com No 160, at para 4.21.

23 The Law Commission Report on *Sale and Supply of Goods,* Law Com No 160, 1987, at paras 4.31-4.32.

Implementation of the Law Commission's recommendation in the 1973 Act and the 1982 Act

7.34 The above recommendation to distinguish between consumer and non-consumer transactions also applied to other types of contracts for the supply of goods.[24] The recommendations for other types of contracts for the supply of goods were implemented in section 11A of the 1973 Act and sections 5A and 10A of the 1982 Act, which were similarly worded.[25] As a result of the restriction on the right of a non-consumer to reject goods for a breach of a statutory condition, the strictness of the classification has to some extent been reduced. Section 11A of the 1973 Act[26] provides as follows:

> *"(1) Where in the case of a hire-purchase agreement –*
>
> *(a) the person to whom the goods are bailed would, apart from this subsection, have the right to reject them by reason of a breach on the part of the creditor of a term implied by section 9, 10 or 11(1)(a) or (c) above, but*
>
> *(b) the breach is so slight that it would be unreasonable for him to reject them,*
>
> *then, if the person to whom the goods are bailed does not deal as consumer, the breach is not to be treated as a breach of condition but may be treated as a breach of warranty.*
>
> *(2) This section applies unless a contrary intention appears in, or is to be implied from, the agreement.*
>
> *(3) It is for the creditor to show -*
>
> *(a) that a breach fell within subsection (1)(b) above, and*
>
> *(b) that the person to whom the goods were bailed did not deal as consumer.*
>
> *(4) The references in this section to dealing as consumer are to be construed in accordance with Part I of the Unfair Contract Terms Act 1977."*

7.35 This new restriction is subject to the parties' contrary intentions. The parties could arrange to enhance a non-consumer's rights on rejection, in which case this new restriction would not apply.

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24 See Law Com No 160, Recommendation (10) in para 8.1, Summary of Recommendations.

25 For sale of goods, see section 15A of the 1979 Act.

26 Sections 5A and 10A of the 1982 Act are in similar wordings.

Conclusion

7.36 The remedies available to a consumer under the 1974 Act of Australia are similar to those available to a buyer under Cap 26, in the sense that the remedies depend on whether the term is a condition or warranty. If the term is a condition, a consumer can reject the goods and treat the contract as repudiated. He can then recover the price if he has already paid. If the term is a warranty, a consumer can only claim damages.

7.37 In the 1993 Act of New Zealand, the statutory implied terms are not classified as conditions or warranties, but guarantees. According to section 18, the remedies available depend on whether the failure to comply with a guarantee can be remedied or not and whether the failure is of a "substantial character". When the failure can be remedied, a consumer has to ask the supplier to remedy the failure first. If the supplier refuses to remedy, neglects to remedy or does not succeed in remedying the failure, the consumer can then reject the goods, or have the failure remedied elsewhere and obtain from the supplier all reasonable costs incurred. When the failure cannot be remedied or is of a "substantial character", a consumer can reject the goods. The expression "substantial character" is defined in section 21.

"Cure" scheme not appropriate for Hong Kong

7.38 In New Zealand, the remedies available do not depend on the classification of the term, but whether the failure to comply with a guarantee can be remedied or not and whether the failure is of a "substantial character". However, it must be pointed that it is not always certain as to which failure can be remedied and which cannot. In addition, a supplier can argue that a failure can be remedied in most cases and a consumer will then be deprived of the right to reject. Furthermore, what amounts to a failure of a "substantial character" is uncertain. The expression "substantial character" is defined in section 21, but the elements of the definition leave room for uncertainty, such as the elements of goods not acquired by a reasonable consumer, departures in significant respects from description or sample, and goods which are substantially unfit for a general or particular purpose.

7.39 A "cure" scheme of a similar nature to that established in the 1993 Act of New Zealand was considered and rejected by the Law Commission of England and Wales[27] in the following terms:

> *"It was suggested that although the scheme sounded superficially attractive, when it was exposed to the merciless test of being put into practice, it was likely to prove a breeding ground for dispute and uncertainty, ultimately leading to a more unsatisfactory situation than exists at present and almost certainly being to the detriment of consumers. …We are, in short, not sufficiently confident that such a scheme would be*

[27] Law Com No 160.

more beneficial to buyers and sellers generally than is the present law."[28]

7.40 The Law Commission was of the view that a "cure" scheme was generally adverse to consumers' interests since it gave suppliers reasons to argue that consumers were not entitled to return the defective goods. Furthermore, even with a "cure" scheme, there are still many unanswered questions:

> "*For example, did the seller have to redeliver the 'cured' goods to the buyer or did the buyer have to collect them? What if by this time the buyer had moved far away? How promptly should the cure be effected? At whose risk were the goods while the cure was in progress? At whose risk were they to be while being redelivered to the buyer? These were but a few of the many practical problems which, it was pointed out, would be likely to arise under this entirely new scheme of remedies, which would probably have to apply to a very great many transactions.*"[29]

7.41 "Cure" schemes may sound attractive preliminarily. But the scheme itself has its own inherent problems and also problems in its implementation as discussed above. Because of the reasons mentioned above, we do not think that a "cure" scheme similar to that established in the 1993 Act is appropriate for Hong Kong.

Classification into "condition" and "warranty"

General considerations

7.42 As to whether the statutory implied terms recommended in the previous chapters for inclusion in the Recommended Legislation should be classified as "conditions" and "warranties", there are three options:

(a) to follow the rigid classification of Cap 26 by using the expressions "condition" and "warranty" and to define them so as to prescribe the remedy for their breaches;

(b) to continue using the expressions "condition" and "warranty" but leave them undefined; or

(c) to abandon the use of the expressions "condition" and "warranty" and to use a neutral word such as "term" to describe the recommended statutory implied terms.

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[28] Law Com No 160, at paras 4.13 - 4.14.

[29] Law Com No 160, at para 4.13.

7.43 There are some advantages to choosing (a). The expressions are defined in the same way as they are defined in Cap 26. The Recommended Legislation on supply of goods will be in line with Cap 26 on sale of goods. The definitions of "condition" and "warranty" will be set out and be transparent to all. There are also disadvantages to option (a). It would perpetuate a rigid distinction between "condition" and "warranty" which determines the remedies available upon breaches of the statutory implied terms.

7.44 Option (b) is a convenient and easy method. Since the 1973 and 1982 Acts in England and the 1974 Act in Australia all adopted this option, Hong Kong would have the benefit of the cases decided in England and Australia in this respect. But there would be similar criticisms regarding the rigidity of classification into "condition" and "warranty". Since these two expressions would not be defined, there would be a lack of transparency and certainty of the meaning as to their precise ambit.

7.45 The advantage of option (c) is that there would be no rigidity of classification. As there is no rigid classification into "condition" and "warranty", courts would be free to interpret the terms as conditions, warranties, or innominate terms. There are also disadvantages to option (c). The Recommended Legislation on contracts for supply of goods will not be in line with Cap 26. If the opportunity were taken to revise the law on sale of goods with regard to the classification, it would be necessary to undertake a thorough review to assess the implications of such a change. In addition, the law of Hong Kong on supply of goods would be out of line with that in England and Australia, whether the law on sale of goods is revised or not. If the law on sale of goods is also revised, the law on sale and supply of goods in Hong Kong will be out of line in this respect with that of England and Australia. In either case, Hong Kong will not have the benefit of the case law in England and Australia.

7.46 On balance, we do not recommend option (c) since this would put the Recommended Legislation on a different footing from Cap 26. There would also be a risk in abandoning overnight the cases decided on remedies for breaches of the statutory implied terms in Cap 26. A decision to abolish the classification of the terms should therefore not be taken lightly. The difference between options (a) and (b) is that in option (b) the two expressions, "condition" and "warranty", are not defined. Nonetheless, the Law Commission, which recommended adopting these two expressions but leaving them undefined, said that it was likely that a similar interpretation applied in the 1979 Act would be adopted in the 1973 and 1982 Acts.[30] If that is the case, the definitions of these two expressions should be made express for the sake of transparency and certainty. We therefore recommend adopting option (a).

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[30] The Commission based their saying on *Halsbury's Laws of England,* 4th Ed, (1979) Vol 9, para 543, n2. See Law Com No 160, at para 2.32.

Special considerations for contracts for work and materials

7.47 The terms implied by the Supply of Services (Implied Terms) Ordinance (Cap 457), which applies to the "work/services" part of contracts for work and materials, are labeled as "implied terms". Should the statutory implied terms recommended for the "materials" part of contracts for work and materials in the Recommended Legislation be classified as "conditions/warranties" as recommended above, or as "implied terms" to be in line with Cap 457? If the former option is adopted, for contracts for work and materials alone, some of the statutory terms will be classified as "conditions/warranties"[31] while others will be labeled as "implied terms".[32] The significance is that the mechanisms for determining the remedies available will be different accordingly.[33]

7.48 Cap 457 was modelled on Part II of the 1982 Act. The statutory implied terms recommended for contracts for work and materials in the Recommended Legislation are similar to those in Part I of the 1982 Act. Therefore, the discussion below about the 1982 Act is also relevant to Hong Kong.

7.49 The terms implied by Part I of the 1982 Act are classified as "conditions/warranties" while those implied by Part II are labeled as "terms". The adoption of "conditions/warranties" in Part I is in line with the common law position in respect of the "materials" part of contracts for work and materials.[34] The adoption of the expression "implied terms" in Part II was deliberate in order to preserve the common law position in respect of contracts for services (and the "work/services" part of contracts for work and materials). In reviewing Part II, the Law Commission of England and Wales has said:

> *"By contrast with the sale of goods legislation, the terms which before the 1982 Act were implied at common law into contracts for services were not categorised as either conditions (breach of which entitles the customer to terminate the contract) or warranties. The 1982 Act preserves the common law in relation to the terms implied under sections 13-15 by using the neutral expression 'term'. It would seem therefore that in accordance with common law principles, the question whether or not in a particular case the statutory implied term has the remedial consequences of a condition would be resolved by construction of the contract."*[35]

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31 Those implied by the Recommended Legislation (for the "materials" part).

32 Those implied by Cap 457 (for the "work/services" part).

33 The remedy for a breach of a term implied by the Recommended Legislation depends on whether the term is classified as a condition or warranty. On the other hand, the remedy for a breach of a term implied by Cap 457 depends on how serious the breach is.

34 See *Young & Marten Ltd v McManus Childs Ltd* [1969] 1 AC 454 as discussed in Chapter 3.

35 The Law Commission, Report on *Implied Terms in Contracts for the Supply of Services,* Law Com No 156, 1986, at para 2.18.

7.50 In effect, for contracts for work and materials alone, the remedy for a breach of a term implied by Part I depends on whether the term is classified as a condition or warranty. On the other hand, the remedy for a breach of a term implied by Part II depends on how serious the breach is.

7.51 Even though the Law Commission of England and Wales was aware of this difference, the Commission did not address it in their relevant reports.[36] There is little literature which addresses this issue.[37] In this connection, the opinions of some leading academics have been sought and are discussed in the following paragraphs.

7.52 There are three options to deal with the difference between the terms implied by Cap 457 and those by the Recommended Legislation for contracts for work and materials:

(a) the terms implied for the "materials" part could be labeled as "implied terms" instead of "conditions/warranties";

(b) the terms implied under Cap 457 could be amended to be labeled as "conditions/warranties" instead of "implied terms"; and

(c) no change to Cap 457, and the terms implied for the "materials" part could continue to be labeled as "conditions/warranties".

(a) option (a)

7.53 The advantage of option (a) is that the terms implied for contracts for work and materials in the Recommended Legislation will be the same as those in Cap 457 (ie implied terms). However, this will bring contracts for work and materials out of line with other types of contracts for the supply of goods. This is undesirable since different types of contracts for the supply of goods should be consistent with each other as far as possible. This was also the basis of the recommendations of the Law Commission of England and Wales on the same subject.[38]

7.54 In addition, the Law Commission of England and Wales concluded that any difficulty with the remedies for breaches of the statutory implied terms could not be overcome merely by removing from them the designation "condition" and simply referring to them as "terms".[39] Furthermore, this would make the terms implied by the Recommended Legislation deviate

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36 The Law Commission, Report on *Implied Terms in Contracts for the Supply of Goods*, Law Com No 95,1979 and Report on *Implied Terms in Contracts for the Supply of Services,* Law Com No 156, 1986.

37 It appears that the report published by the National Consumer Council in 1981 *'Services Please - Services and the Law: a Consumer View*', which brought about Part II of the 1982 Act, has not dealt with this issue specifically.

38 The Law Commission, *Implied Terms in Contracts for the Supply of Goods,* Working Paper No 71, 1977, at para 16. The Law Commission, Report on *Implied Terms in Contracts for the Supply of Goods,* Law Com No 95, 1979, at para 33.

39 The Law Commission, *Sale and Supply of Goods*, Working Paper No 85, 1983, at para 4.30.

from the existing common law position. It appears that option (a) is not appropriate.

(b) option (b)

7.55 The advantage of option (b) is the same as that of option (a). For the following reasons, option (b) is also not appropriate. First, amending the labels of the terms implied under Cap 457 from "implied terms" to "conditions/warranties" will open the debate concerning designations of the terms implied for contracts for services, which was settled upon the enactment of Cap 457. This proposal to amend Cap 457 is made solely to remove the differences between the terms implied by Cap 457 and those by the Recommended Legislation, rather than on the basis of what is appropriate for contracts for services.

7.56 It is difficult to justify the proposed amendment to Cap 457 on the basis of its merits so far as contracts for services themselves are concerned. Professor Reynolds correctly pointed out that the *Hong Kong Fir test* was more appropriate for contracts for services, since breaches of those contracts varied very much in seriousness. Apart from this, services, unlike materials, are intangible. Terms implied by Cap 457 therefore include a "reasonableness" test, such as "reasonable care and skill" in section 5.[40] Even if the implied term in section 5 is made a condition, this will not enhance certainty since the determination of whether or not there is a breach of the condition will depend on how the "reasonableness" test is applied. For these reasons, this proposal for amendment is not justified.

7.57 Besides, amendment of Cap 457 arguably goes beyond the terms of reference of this Sub-committee even though this should not be a hindrance to discussion. In addition, option (b) will make Cap 457 deviate from the common law position.

(c) option (c)

7.58 Under option (c), both Cap 457 and the terms implied by the Recommended Legislation for contracts for work and materials will still reflect the common law position. Indeed, Part I and Part II of the 1982 Act in England & Wales correspond to this position.

7.59 However, the concern that in respect of contracts for work and materials alone, some statutory implied terms are classified as "conditions/warranties" (the "materials" part) while others are not (the "work/services" part) will still exist. Professor Reynolds pointed out that it could be justified by the difference in nature between materials and services, and the difference between breaches concerning the "materials" part and those concerning the "work/services" part. He said that breaches of the

[40] Similar term in section 13 of Part II of the 1982 Act.

"work/services" part varied in nature and seriousness.[41] In explaining the reasons for the difference, Professor Reynolds has suggested:

> *"the difference between services and materials is that with materials one can specify more accurately what is wanted and so designate those specifications as conditions, whereas breaches of service contracts vary very much in nature and seriousness, so that the Hong Kong Fir test is more appropriate."*[42]

(d) conclusion

7.60 It seems that option (c) is the safest option for the following reasons. First, it reflects the existing common law position in Hong Kong. Secondly, this is the existing position in England and Wales under the 1982 Act. Professor Len Sealy has said:

> *"The distinction between 'conditions', 'warranties' and 'terms' ('innominate terms') in the 1982 Act was intentional, and it was meant to reflect the position at common law …. I am sure that the Law Commission did not wish to alter what had been well settled law here for most of a century."*[43]

7.61 Lastly, some academics find such a difference maintained in the 1982 Act justifiable.[44] In any event, this has not been criticised so far. Professor Guenter Treitel has said:

> *"I am not troubled by the fact that where the contract is one for the supply of materials and services the implied term with regard to the conformity of the materials is classified differently [from that for the services] in the 1982 Act, ie as a 'condition'."*[45]

7.62 Unless there is a strong reason for choosing otherwise, it appears that option (c) is the most appropriate option even though differences between the terms implied by Cap 457 and those by the Recommended Legislation will still exist.[46]

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41 In general, materials are tangible and services are intangible, and therefore, with materials one can specify more accurately what is wanted. However, it must be pointed out that breaches concerning the "materials" part can also vary in nature and seriousness.

42 In an e-mail dated 23 Oct 1999 to the Secretary of the Sub-committee. Professor Reynolds assumed that the parties would designate the specifications on materials as conditions - *"one can specify more accurately what is wanted and so designate those specifications as conditions …"*. But the present discussion is about implied terms, which would apply even though the parties have not specified them as conditions or even just terms.

43 In an e-mail dated 6 November 1999 to the Secretary of the Sub-committee.

44 In an e-mail from Professor Reynolds dated 23 Oct 1999 as discussed above to the Secretary of the Sub-committee.

45 In an e-mail dated 10 November 1999 to the Secretary of the Sub-committee.

46 In any event, there are two other differences. First, duties imposed by Part I of the 1982 Act (the Recommended Legislation) are strict liabilities, while those imposed by Part II of the 1982 Act (Cap 457) are duties of due care only, for example, "reasonable care and skill".
Secondly, as to restrictions on contracting out, Part I of the 1982 Act (the Recommended Legislation) is governed by sections 6 and 7 of the Unfair Contract Terms Act 1977 (sections

Recommendation 18

We recommend following the classification of terms in the Sale of Goods Ordinance (Cap 26) by using the expressions "condition" and "warranty" and defining them in the same way as in Cap 26.

Restriction on non-consumers' rights to reject goods

Is such a restriction appropriate for Hong Kong?

7.63 The Law Commission of England and Wales[47] has differentiated between consumer and non-consumer contracts of sale and supply of goods in respect of the right to reject goods. Obviously, there is a distinction between the interests of consumers and non-consumers. Consumers acquire goods for their own use and not for profit. A reduction in price or compensation for defective goods will not necessarily satisfy the needs of a consumer since he acquires the goods because of his wish to have goods in working condition for his own consumption. In addition, it is usually not easy for a consumer to dispose of defective goods, nor to quantify his loss. Last but not least, sellers or suppliers usually have much stronger bargaining power than consumers do.

7.64 On the other hand, non-consumers acquire goods for commercial purposes and it is easier therefore to quantify their losses. Monetary compensation can usually compensate non-consumers for defective goods and non-consumers can more readily dispose of defective goods. Furthermore, the motives behind the rejection of goods by consumers and non-consumers can be different. Consumers normally reject goods because defective goods cannot satisfy their needs. Non-consumers may, for business reasons, choose to reject goods for trivial or slight defects because of market fluctuations.

7.65 For these reasons, there should be a differentiation in the treatment of consumers from that of non-consumers in contracts for the supply of goods, in respect of their rights to reject defective goods. The Law Commission's recommendations in this respect, as implemented in section 11A of the 1973 Act and sections 5A and 10A of the 1982 Act, should shed light on the Recommended Legislation in Hong Kong.

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11 and 12 of the Control of Exemption Clauses Ordinance (Cap 71)). Part II of the 1982 Act (Cap 457) is governed by sections 2 and 3 of the 1977 Act (sections 7 and 8 of Cap 71) which are more lenient. See PS Atiyah, *The Sale of Goods,* 9th Ed, 1995, at p 21.
Professor Treitel also said: "*A somewhat similar distinction exists at common law where the issue is as to the standard of liability under such a contract: liability for defects in the materials is strict but liability for defects in the services is not*" in an e-mail dated 10 November 1999 to the Secretary of the Sub-committee.
See also G Treitel, *The Law of Contract*, 10th Ed, 1999, at p 780.

47 Law Com No 160, at paras 4.1- 4.34.

(a) criticisms of the new restriction

7.66 There are three major criticisms of this new restriction on non-consumers' rights to reject goods. First, the scope of the restriction is too narrow. Professor P S Atiyah[48] regrets that it only applies to breaches of a supplier's statutory duties and that it should be enlarged to the general law of contract. Professor Reynolds[49] is of the view that it is of "severely limited effect" and makes "little difference in practice". Professor Treitel has also said:

> *" …the section scarcely goes far enough to promote justice: for this purpose, the right to reject should be restricted to serious breaches and not merely excluded if the breach is slight …. rescission by a seller can lead to just as much injustice as rejection by the buyer; but the section does nothing to limit the exercise by a seller of a right to rescind."*[50]

7.67 Secondly, the restriction creates uncertainties. Professor Sealy has pointed out that the restriction is "a bad reform, because it [introduces] uncertainty".[51] Professor Treitel has also made similar remarks:

> *"[t]he question just when a breach is so slight as to make it unreasonable for the buyer to reject the goods remains to be settled by judicial decision; and the vagueness of section 15A on this point is a source of regrettable uncertainty …the section undermines the certainty which classification of the implied terms in question as conditions was intended to provide …. It is submitted that the section has sacrificed certainty without attaining justice*."[52]

7.68 Thirdly, the new restriction does not apply where a contrary intention appears in, or is to be implied from, the agreement. Both Professor Reynolds[53] and Professor Treitel[54] are of the view that it is uncertain as to when the restriction will be impliedly excluded. Professor Treitel has said that such an implication can arise from "the nature of the contract or from its commercial setting".[55]

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48 P S Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 450.

49 *Benjamin's Sale of Goods*, 5th Ed, 1997, para 12-026.

50 G Treitel, *The Law of Contract*, 10th Ed, 1999 at p 745. Brian Childs has also made similar comments that the new section does not apply to other obligations of a seller other than those statutory implied terms, or where it is the seller who seeks to escape from the contract. Brian Childs, "Goodbye to all that?" (1995) 46 NILQ 232, at p 241-242.

51 In an e-mail dated 6 Nov 1999 to the Secretary of the Sub-committee.

52 G Treitel, *The Law of Contract*, 10th Ed, 1999 at p 744-745.

53 *Benjamin's Sale of Goods*, 5th Ed, 1997, para 12-026.

54 G Treitel, *The Law of Contract*, 10th Ed, 1999 at p 745.

55 G Treitel, *The Law of Contract*, 10th Ed, 1999 at p 744. The Law Commission of England and Wales stated that it would be normal to infer an intention that any breach of a time clause, however slight, would justify rejection of the goods, whether or not such a clause was part of the description of the goods (ie within section 13 of the 1979 Act). Law Com No 160 at para 4.24.

(b) in favour of the new restriction

7.69 In the following paragraphs, we will deal with the academics' criticisms of the restriction one by one. As far as the criticism as to the limited scope of section 15A is concerned, since we only recommend introducing statutory implied terms on suppliers' duties to customers, it is appropriate that the application of the restriction on the right to reject goods should be limited to those implied terms. The implication of extending the application to the law of contract is too complex to be dealt with under the present terms of reference.

7.70 In relation to the criticism that the application of the restriction is uncertain, we acknowledge that the question when a breach is so slight as to make it unreasonable for a buyer to reject creates uncertainties. Indeed, whenever there is any deviation from the strict adherence to the classification of terms, there will be uncertainties. We also acknowledge that certainty and predictability of the law are usually what the commercial community wants. However, a balance has to be struck between certainty and justice, as the Law Commission of England and Wales has pointed out.[56] The Commission argued that the uncertainty would be "more apparent than real and [was] a price worth paying". We emphasise that the restriction can prevent injustice by disallowing rejection of goods for slight defects. Even though the restriction may bring about some uncertainties, the price of a certain degree of uncertainty is, we believe, worth paying. Professor Atiyah also shares this view and has said:

> "*Of course, as the Law Commission recognised, these changes in the law would introduce some element of uncertainty where previously the right of rejection was unqualified, but this may well be an acceptable price to pay for penalising totally unreasonable commercial behaviour*."[57]

7.71 As to the uncertainty concerning when the new restriction will be impliedly excluded, we accept that such a provision would create some uncertainties as to the application of the new section. On the other hand, if the new section can only be excluded expressly, it may not achieve its purpose since not all non-consumers will be aware of the need to make the exclusion express, nor will due recognition be given to the parties' intention in every case. We agree with the Law Commission that "in the appropriate circumstances there [would] be no difficulty in inferring" the parties' intention to exclude the application of the new section.[58] In this connection, we conclude that the parties can exclude the new section either expressly or by implication.

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56 Law Com No 160 at para 4.23.

57 P S Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 451.

58 Law Com No 160 at para 4.23.

7.72 On balance, we recommend adopting a new restriction on non-consumers' rights to reject goods similar to that in England, since it can prevent rejection of goods for slight defects. As discussed above, the classification of the terms into "conditions" and "warranties" has long been considered too inflexible. The strictness of the classification causes injustice in some cases. We concluded above that it was too drastic to do away with the classification altogether. In order to prevent the injustice that may be caused, however, we recommend incorporating the restriction applied in England, which should be able to reduce the strictness of the classification. Geraint Howells[59] has mentioned that the new restriction removes the danger of unfairness in commercial transactions, which might result from goods which are commercially usable being rejected for non-functional defects. Professor P S Atiyah[60] has also stated:

> *"These changes are generally to be welcomed, because there is no doubt that the former law permitted rejection on capricious and technical grounds. In particular, rejection was often justified on the ground of a technical breach of the statutory implied terms, even though the buyer's real motive in rejecting the goods was that market prices had fallen since the contract was made."*

7.73 It must be pointed out that this recommended restriction on non-consumers' rights to reject goods applies to trivial breaches of some, but not all, statutory implied terms in the Recommended Legislation. A right to transfer the property in goods (in a contract for the transfer of property in goods)[61] and a right to have a reasonable opportunity to compare the bulk with the sample are not matters of degree. But the new restriction on non-consumers' rights to reject goods applies only where the breach is slight. The recommended restriction should therefore not apply to implied conditions in respect of these two matters. In addition, since the restriction is to limit a non-consumer's right of rejection, it should be for a supplier to prove that the restriction is applicable.

7.74 On the other hand, consumers' rights to reject remain intact since consumers acquire goods for self-use and expect the goods to be in working condition. A reduction in price or monetary compensation will not necessarily satisfy their needs. We therefore recommend that non-consumers' rights to reject defective goods should be limited to non-trivial breaches while consumers' rights to reject should be unfettered.

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59 Geraint Howells, "The Modernisation of Sales Law?" [1995] LMCLQ 191, at p193. Ian Brown has also said that these are desirable recommendations. Ian Brown "The Meaning of Merchantable Quality in Sales of Goods: Quality or Fitness for Purpose?" [1987] LMCLQ 400, at p 405.

60 P S Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 450.

61 A right to transfer possession of the goods by way of hire for the period of bailment (in a contract for the hire of goods); a right to sell the goods at the time when the property is to pass (in a hire purchase agreement).

Relevance of non-consumers' individual circumstances to the "reasonableness" test

7.75 The new restriction on non-consumers' rights to reject goods in England is silent as to how far the individual circumstances of non-consumers will be relevant in determining the question of reasonableness. Unfortunately, we have been unable to find any case law on this issue. In making their recommendation, the Law Commission of England and Wales stressed that a non-consumer's *"motive in seeking to reject the goods and treat the contract as repudiated would not be relevant".*[62] The Law Commission also stated that an element of subjectivity is undesirable:

> *"This test is broadly similar to that suggested in the Consultative Document save that the Law Commission considers that it would be better not to refer to 'the consequences' of the breach. Such a test, as was pointed out on consultation, might admit an element of subjectivity which the Law Commission considers (as stated in the Consultative Document) to be undesirable."*[63]

7.76 Professor Atiyah has pointed out that it is *"not entirely clear how far the personal position of the buyer will be relevant in examining the question of reasonableness".*[64] He has further said:

> *"Presumably if the buyer has his own good reasons for needing goods which are in precise conformity with the contract (even if this was not known to the seller) it will not be unreasonable of him to reject them for any slight nonconformity. … It is also unclear whether other personal circumstances of the buyer (his market position, for instance) will be relevant in deciding whether rejection is reasonable."*

7.77 Professor Reynolds is of the view that the test of reasonableness is an objective one:

> *"It is also stated that the buyer's motives for rejection are not intended to be regarded as relevant, as 'subjectivity' is referred to as undesirable. It appears therefore that the test of reasonableness is intended to be an objective one, though it still ought to be geared to a person in the buyer's position rather than an external observer."*[65]

7.78 Professor Reynolds has said subsequently: *"I do not agree with Professor Atiyah: the matter should be one of the understanding between the parties, objectively ascertained. Unknown factors peculiar to the buyer should*

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62 Law Com No 160 at para 4.19.
63 Note 23, Part 4, Law Com No 160.
64 P S Atiyah, *The Sale of Goods*, 9th Ed, 1995 at p 451.
65 *Benjamin's Sale of Goods*, 5th Ed, at para 12-026.

not be relevant."[66] When referred to the different views of Professor Atiyah and Professor Reynolds, Professor Treitel has said:

> *"It seems to me that Professor Reynolds must be right. The burden of proof which s15A(3) puts on the seller would be virtually impossible to discharge if the buyer's personal idiosyncrasies could be a ground for rejection under s15A."*[67]

7.79 Professor Sealy also has pointed out that subjective factors should be irrelevant. He has said: *"I am sure that subjective reasons which are entirely personal (like changing your mind) would never influence the court …any degree of subjectivity in the test could lead to a great deal of uncertainty."*[68]

7.80 After considerable deliberation, we have come to the conclusion that the proposed "reasonableness" test should be objective. This is in line with the views of the Law Commission and the academics' opinions mentioned above. The test should be an objective one to be judged in the particular context in question, and not in a vacuum. The court would take into account the factual circumstances of a non-consumer and consider how a reasonable man would react in those circumstances. We agree with Professor Reynolds that the test *"is intended to be an objective one, though it still ought to be geared to a person in the buyer's position rather than an external observer."*[69]

7.81 We have considered, instead of simply adopting the English provision, adopting it with adjustments by putting in the Recommended Legislation lists of those non-consumers' circumstances which should be (and those which should not be) considered in applying the test, or some criteria as to what circumstances should be considered. For the following reasons, we recommend adopting the English provision without adjustments. First, any list of circumstances can hardly be exhaustive, nor can such criteria be applicable to all cases. Secondly, apart from the question of feasibility, it would be undesirable to restrain unduly the court's freedom to decide in individual cases. Thirdly, a list of circumstances or criteria would tend to limit the parties' minds to whether a non-consumer's circumstances fall within this statutory list, rather than on the "reasonableness" of the rejection itself. Fourthly, in recommending the implied condition as to fitness for any particular purpose in Chapter 5, an exception is provided for circumstances where a

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66 In an e-mail dated 23 Oct 1999 to the Secretary of the Sub-committee.

67 In an e-mail dated 10 Nov 1999 to the Secretary of the Sub-committee.

68 In an e-mail dated 6 Nov 1999 to the Secretary of the Sub-committee. Professor Sealy also said in his e-mail: "*what worries me most is the position of a buyer who has contracted to resell the goods. Suppose A has agreed to sell to B and B has agreed to resell to C, and suppose that B has no obvious reason himself to reject the goods - he will be bound to accept them. Then he delivers them to C who (the court holds) does have a good reason. B will be stuck with the goods. Now suppose that there are ten sub-buyers in the chain, and only the tenth has a good reason. In litigation between A and B, neither of them is likely to know who is going to be the ultimate buyer and what his personal circumstances are. ... But, if you were a judge, would you feel entitled to take account of the fact that B had agreed to resell? And would it be relevant whether A knew, or might have suspected, this?*"

69 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 12-026.

customer does not rely, or it is "unreasonable for him" to rely, on the supplier. The same phrase "unreasonable for him" also appears in section 16(3) of Cap 26[70] with no further explanation. In this connection, it is desirable to formulate the "reasonableness" test consistently.[71] Fifthly, as adopting the English provision without adjustment, Hong Kong will have the benefit of guidance from the relevant English cases.

7.82 Having said this, we would make the following additional points. First, we agree with the views of the Law Commission and the academics discussed above that a non-consumer's personal idiosyncrasies should not be a ground for rejection and his motive for rejection should not be relevant in assessing reasonableness.

7.83 Secondly, despite the objectivity of the test, the reasonableness of the rejection by a non-consumer should be measured against non-consumers of the same nature (scale of operation) as the non-consumer in question. In recommending different measures to reform the remedies for consumers and non-consumers, the Law Commission was aware that there were some "borderline" non-consumers who were *"probably in very much the same position as an individual consumer".*[72] An example would be a small corner shop which buys a refrigerator for use in the shop.

7.84 Non-consumers can have varying scales of operation, from a small retailer to a large corporation. While a large corporation in practice may have stronger bargaining power, a small corner shop will be *"probably in very much the same position as an individual consumer if the refrigerator proves to be defective"*[73] in the above example. The owner of the small corner shop expects to buy a refrigerator in working condition to refrigerate his wares. A reduction in price or compensation for the defective refrigerator does not necessarily satisfy his wish to have a working refrigerator. It is not easy for him to dispose of the defective refrigerator in the market either. In such a case, the owner is very much like a consumer, and his right of rejection should justifiably be as unfettered as that of a consumer. Therefore, to set a fairer yardstick, in assessing the reasonableness of the rejection by a non-consumer, the non-consumer should be measured against non-consumers of the same nature (scale of operation).

Consequential amendment to Cap 26

7.85 We must point out that if the above recommendation as to restriction on non-consumers' rights of rejection is enacted in the Recommended Legislation, it will be necessary to amend Cap 26 consequentially for the sake of consistency.

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70 "*[E]xcept where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the seller's skill or judgment*".

71 "[*T]he breach is so slight that it would be unreasonable for him to reject them*". See section 11A of the 1973 Act and sections 5A and 10A of the 1982 Act.

72 Law Com No 160, 1987, at para 4.6.

73 Law Com No 160, 1987, at para 4.6.

Recommendation 19

We recommend that the Recommended Legislation should include the following features:

(a) the rights of a consumer to treat a contract of supply as repudiated on a breach of the statutory implied terms in the Recommended Legislation should be unfettered;

(b) in the case of a non-consumer, if the breach is so slight that it would be unreasonable for him to repudiate the contract of supply, the breach will only be treated as a breach of warranty but not a condition; and

(i) the burden is on the supplier to show that the breach is so slight that it would be unreasonable for the other party to repudiate the contract, and that other party does not deal as a consumer;

(ii) this restriction on rejection does not apply where there is an express or implied contrary intention in the contract;

(iii) this restriction does not apply where the breach is a breach of :

- **an implied condition as to a reasonable opportunity to compare the bulk with the sample;**
- **an implied condition as to a right to transfer the property in goods (in a contract for the transfer of property in goods);**
- **an implied condition as to a right to transfer possession of the goods by way of hire for the period of bailment (in a contract for the hire of goods); or**

- **an implied condition as to a right to sell the goods at the time when the property is to pass (in a hire purchase agreement).**

Who are consumers?

7.86 As to who is a consumer, there is an existing definition in the Hong Kong legislation. Section 2A of Cap 26 defines "deals as consumer" as follows:

> *"(1) A party to a contract of sale 'deals as consumer' in relation to another party if –*
>
> *(a) he neither makes the contract in the course of a business nor holds himself out as doing so;*
>
> *(b) the other party does make the contract in the course of a business; and*
>
> *(c) the goods passing under or in pursuance of the contract are of a type ordinarily supplied for private use or consumption.*
>
> *(2) Notwithstanding subsection (1), on a sale by auction or by competitive tender the buyer is not in any circumstances to be regarded as dealing as consumer.*
>
> *(3) It is for the person claiming that a party does not deal as consumer to prove that he does not."*

7.87 Section 2A of Cap 26 is almost identical to section 4 of the Control of Exemption Clauses Ordinance (Cap 71). Professor P S Atiyah[74] has commented on section 12 of the Unfair Contract Terms Act 1977 (the equivalent of section 2A of Cap 26) that, in general, the section is clear enough. We are also of the view that section 2A of Cap 26 should provide a good basis for the definition of the expression "consumers" in the Recommended Legislation and we so recommend.

Recommendation 20

We recommend that the definition of "dealing as consumers" in the Recommended Legislation should follow that in section 2A of the Sale of Goods Ordinance (Cap 26).

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[74] P S Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 201.

Chapter 8

Exclusion of liability

Overview

8.1 In this chapter, we discuss exclusion of liability for breaches of the implied terms under the Recommended Legislation and its control. We first examine the present position of exclusion of liability for breaches of the implied terms in contracts of sale of goods and other kinds of supply of goods in Hong Kong. We also discuss the position in Australia, New Zealand and England and Wales.

8.2 After discussing the relevant issues, we then make recommendations in respect of –

(a) contracting out the liabilities for breaches of the implied terms under the Recommended Legislation and making it subject to the control of Cap 71 – **Recommendation 21**;

(b) a new sub-section (3A) to be added to section 12 of Cap 71 – **Recommendation 22**; and

(c) the amendment of section 12 of Cap 71 to cover agreements to transfer property in goods and agreements to bail goods - **Recommendation 23**.

Exclusion of liability in contracts of sale of goods and other contracts for the supply of goods in Hong Kong

Exclusion of liability in contracts of sale of goods

8.3 Exclusion of liability under Cap 26 in contracts of sale of goods is allowed under section 57 of Cap 26 which reads as follows:

> *"(1) Where any right, duty or liability would arise under a contract of sale of goods by implication of law, it may (subject to the Control of Exemption Clauses Ordinance (Cap 71)) be negatived or varied by express agreement, or by the course of dealing between the parties, or by*

usage if the usage is such as to bind both parties to the contract.

(2) An express condition or warranty does not negative a condition or warranty implied by this Ordinance unless inconsistent therewith."

8.4 The liability of a seller for breaching the statutory implied terms under Cap 26 can be excluded or limited by express agreement, the course of dealing between the parties or usage, but this is subject to the control of the Control of Exemption Clauses Ordinance (Cap 71). Cap 71 is based on the Unfair Contract Terms Act 1977 of England and Wales (the "1977 Act"). The control on exemption clauses of a seller's liability is provided in section 11 as follows:

"(1) Liability for breach of the obligations arising from section 14 of the Sale of Goods Ordinance (Cap 26) (seller's implied undertakings as to title, etc) cannot be excluded or restricted by reference to any contract term.

(2) As against a person dealing as consumer, liability for breach of the obligations arising from section 15, 16 or 17 of the Sale of Goods Ordinance (Cap 26) (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose) cannot be excluded or restricted by reference to any contract term.

(3) As against a person dealing otherwise than as consumer, the liability specified in subsection (2) can be excluded or restricted by reference to a contract term, but only in so far as the term satisfies the requirement of reasonableness.

(4) The liabilities referred to in this section are not only the business liabilities defined by section 2(2), but include those arising under any contract of sale of goods."

8.5 According to section 11(1), the liability for breaching the implied undertaking as to title, etc cannot be excluded or restricted. If a buyer deals as a consumer, the implied undertakings as to correspondence with description or sample, or as to quality or fitness for purposes, cannot be excluded or restricted. But if a buyer does not deal as a consumer, these implied terms can be excluded or restricted, provided the exemption clause is reasonable. The test of "reasonableness" is set out in section 3.

Exclusion of liability in contracts of other kinds of supply of goods

8.6 Apart from the particular provision on contracts of sale of goods in section 11, section 12 of Cap 71 also provides for other contracts for the supply of goods. Section 12 reads as follows:

> *"(1) Where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods, subsection (2) to (4) apply in relation to the effect (if any) that the court or arbitrator is to give to contract terms excluding or restricting liability for breach of obligation arising by implication of law from the nature of the contract.*
>
> *(2) As against a person dealing as consumer, liability in respect of the goods' correspondence with description or sample, or their quality or fitness for any particular purpose, cannot be excluded or restricted by reference to any such term.*
>
> *(3) As against a person dealing otherwise than as consumer, that liability can be excluded or restricted by reference to such a term, but only in so far as the term satisfies the requirement of reasonableness.*
>
> *(4) Liability in respect of –*
>
> *(a) the right to transfer ownership of the goods, or give possession; or*
>
> *(b) the assurance of quiet possession to a person taking goods in pursuance of the contract,*
>
> *cannot be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness."*

8.7 According to section 12(4), the liability for a breach of the obligation as to the right to transfer ownership or possession of the goods, or the assurance of quiet possession cannot be excluded or restricted unless the exemption clause is reasonable. If the person who deals with a supplier is a consumer, the obligations as to correspondence with description or sample, or as to quality or fitness for purposes cannot be excluded or restricted. If the person who deals with a supplier is not a consumer, these obligations can be excluded or restricted provided the exemption clause is reasonable.

8.8 "Dealing as consumer" is defined in section 4. The definition is almost identical to that in section 2A of Cap 26, which has been discussed in Chapter 7. The test of "reasonableness" is set out in section 3 as follows:

"(1) In relation to a contract term, the requirement of reasonableness for the purposes of this Ordinance and section 4 of the Misrepresentation Ordinance (Cap 284) is satisfied only if the court or arbitrator determines that the term was a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

(2) In determining for the purposes of section 11 or 12 whether a contract term satisfies the requirement of reasonableness, the court or arbitrator shall have regard in particular to the matters specified in Schedule 2; but this subsection does not prevent the court or arbitrator from holding, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.

(3) In relation to a notice (not being a notice having contractual effect), the requirement of reasonableness under this Ordinance is satisfied only if the court or arbitrator determines that it would be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen.

(4) In determining (under this Ordinance or the Misrepresentation Ordinance (Cap 284)) whether a contract term or notice satisfies the requirement of reasonableness, the court or arbitrator shall have regard in particular (but without prejudice to subsection (2) to whether (and, if so, to what extent) the language in which the term or notice is expressed is a language understood by the person as against whom another person seeks to rely upon the term or notice.

(5) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this Ordinance or the Misrepresentation Ordinance (Cap 284)) whether the term or notice satisfies the requirement of reasonableness, the court or arbitrator shall have regard in particular (but without prejudice to subsection (2) or (4)) to –

(a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and

(b) how far it was open to him to cover himself by insurance.

(6) It is for the person claiming that a contract term or notice satisfies the requirement of reasonableness to prove that it does."

8.9 According to sub-section (1), an exemption clause is reasonable if the court determines that it is fair and reasonable, *"having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made."* Pursuant to sub-section (2), for contracts of sale of goods and supply of goods, the court shall have regard in particular to the following matters specified in Schedule 2:

"The matters to which the court or arbitrator shall have regard in particular for the purposes of sections 11(3) and 12(3) and (4) are any of the following which appear to be relevant –

(a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;

(b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;

(c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);

(d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;

(e) whether the goods were manufactured, processed or adapted to the special order of the customer."

Australia

8.10 In Australia, the general rule is that the liability for breaching the statutory implied terms in Part V Division 2 of the 1974 Act cannot be excluded or restricted. Section 68(1) provides as follows:

"Any term of a contract (including a term that is not set out in the contract but is incorporated in the contract by another term of

the contract) that purports to exclude, restrict or modify or has the effect of excluding, restricting or modifying:

(a) the application of all or any of the provisions of this Division;

(b) the exercise of a right conferred by such a provision;

(c) any liability of the corporation for breach of a condition or warranty implied by such a provision; or

(d) the application of section 75A;

is void."

8.11 The general rule is subject to an exception in section 68A(1)(a). Where the goods are not of a kind ordinarily acquired for "personal, domestic or household use or consumption", the liability of a supplier can be restricted to replacement of, repair of or the costs of replacing or repairing the goods. Sub-section (1)(a) provides as follows:

"(1) Subject to this section, a term of a contract for the supply by a corporation of goods or services other than goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption is not void under section 68 by reason only that the term limits the liability of the corporation for a breach of a condition or warranty (other than a condition or warranty implied by section 69) to:

(a) in the case of goods, any one or more of the following:

(i) the replacement of the goods or the supply of equivalent goods;

(ii) the repair of the goods;

(iii) the payment of the cost of replacing the goods or of acquiring equivalent goods;

(iv) the payment of the cost of having the goods repaired."

8.12 According to sub-section (2), an exemption clause has no effect if a consumer can establish that it is not fair or reasonable for the supplier to rely on that clause. In determining the fairness or reasonableness, a court shall have regard to all the circumstances and in particular the 4 matters specified in sub-section (3) which are similar to those specified in Schedule 2 of Cap 71. Sub-sections (2) and (3) read as follows:

"(2) Subsection (1) does not apply in relation to a term of a contract if the person to whom the goods or services were supplied establishes that it is not fair or reasonable for the corporation to rely on that term of the contract.

(3) In determining for the purposes of subsection (2) whether or not reliance on a term of a contract is fair or reasonable, a court shall have regard to all the circumstances of the case and in particular to the following matters:

(a) the strength of the bargaining positions of the corporation and the person to whom the goods or services were supplied (in this subsection referred to as 'the buyer') relative to each other, taking into account, among other things, the availability of equivalent goods or services and suitable alternative sources of supply;

(b) whether the buyer received an inducement to agree to the term or, in agreeing to the term, had an opportunity of acquiring the goods or services or equivalent goods or services from any source of supply under a contract that did not include that term;

(c) whether the buyer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties); and

(d) in the case of the supply of goods, whether the goods were manufactured, processed or adapted to the special order of the buyer."

New Zealand

8.13 In New Zealand, according to section 43(1) of the 1993 Act, *"the provisions of this Act shall have effect notwithstanding any provision to the contrary in any agreement."* Pursuant to sub-section (2)(a), this prohibition on contracting out does not apply where a consumer acquires or holds himself out as acquiring the goods for business provided the agreement is in writing. Sub-section (2)(a) reads as follows:

"(2) Nothing in subsection (1) of this section shall apply to an agreement made between a supplier and a consumer who acquires, or holds himself or herself out as acquiring,

under the agreement, goods or services for the purposes of a business provided either –

(a) That the agreement is in writing …"

8.14 According to sub-section (6), parties may agree in writing to impose a stricter duty on a supplier than that imposed by the Act or provide a more advantageous remedy to a consumer. In addition, a consumer may also agree to settle or compromise a claim under the Act (sub-section (7)).

England and Wales

8.15 Exemption clauses are allowed in hire purchase agreements under section 12 of the 1973 Act, and in contracts for the transfer of property in goods and contracts of hire under section 11 of the 1982 Act. Sections 12 and 11 provide as follows respectively:

"12 Exclusion of implied terms

An express term does not negative a term implied by this Act unless inconsistent with it."

"11 Exclusion of implied terms, etc

(1) Where a right, duty or liability would arise under a contract for the transfer of goods or a contract for the hire of goods by implication of law, it may (subject to subsection (2) below and the 1977 Act) be negatived or varied by express agreement, or by the course of dealing between the parties, or by such usage as binds both parties to the contract.

(2) An express condition or warranty does not negative a condition or warranty implied by the preceding provisions of this Act unless inconsistent with it.

(3) Nothing in the preceding provisions of this Act prejudices the operation of any other enactment or any rule of law whereby any condition or warranty (other than one relating to quality or fitness) is to be implied in a contract for the transfer of goods or a contract for the hire of goods."

8.16 Exemption clauses are also subject to the control of sections 6 and 7 of the 1977 Act. Exemption clauses in contracts of sale of goods and hire purchase agreements are governed by section 6, while exemption clauses in contracts for the transfer of property in goods and contracts of hire are governed by section 7. Sections 6 and 7 read as follows:

"6 Sale and hire-purchase

(1) Liability for breach of the obligations arising from –

(a) section 12 of the Sale of Goods Act 1979 (seller's implied undertakings as to title, etc);

(b) section 8 of the Supply of Goods (Implied Terms) Act 1973 (the corresponding thing in relation to hire-purchase),

cannot be excluded or restricted by reference to any contract term.

(2) As against a person dealing as consumer, liability for breach of the obligations arising from –

(a) section 13, 14 or 15 of the 1979 Act (seller's implied undertakings as to conformity of goods with description or sample, or as to their quality or fitness for a particular purpose);

(b) section 9, 10 or 11 of the 1973 Act (the corresponding things in relation to hire-purchase),

cannot be excluded or restricted by reference to any contract term.

(3) As against a person dealing otherwise than as consumer, the liability specified in subsection (2) above can be excluded or restricted by reference to a contract term, but only in so far as the term satisfies the requirement of reasonableness.

(4) The liabilities referred to in this section are not only the business liabilities defined by section 1(3), but include those arising under any contract of sale of goods or hire-purchase agreement.

7 Miscellaneous contracts under which goods pass

(1) Where the possession or ownership of goods passes under or in pursuance of a contract not governed by the law of sale of goods or hire-purchase, subsections (2) to (4) below apply as regards the effect (if any) to be given to contract terms excluding or restricting liability for breach of

obligation arising by implication of law from the nature of the contract.

(2) As against a person dealing as consumer, liability in respect of the goods' correspondence with description or sample, or their quality or fitness for any particular purpose, cannot be excluded or restricted by reference to any such term.

(3) As against a person dealing otherwise than as consumer, that liability can be excluded or restricted by reference to such a term, but only in so far as the term satisfies the requirement of reasonableness.

(3A) Liability for breach of the obligations arising under section 2 of the Supply of Goods and Services Act 1982 (implied terms about title etc in certain contracts for the transfer of the property in goods) cannot be excluded or restricted by references to any such term.

(4) Liability in respect of –

(a) the right to transfer ownership of the goods, or give possession; or

(b) the assurance of quiet possession to a person taking goods in pursuance of the contract,

cannot (in a case to which subsection (3A) above does not apply) be excluded or restricted by reference to any such term except in so far as the term satisfies the requirement of reasonableness."

8.17 Sections 6 and 7 of the 1977 Act are similar to sections 11 and 12 of Cap 71 in Hong Kong except that section 6 also governs exemption clauses in hire purchase agreements and the 1982 Act inserted a new sub-section (3A) in section 7. The effect of the new sub-section (3A) is that any exemption clause relating to implied terms as to title, etc, in contracts for the transfer of property in goods shall be void. This is in line with the existing similar provision in section 6(1) in respect of contracts of sale of goods and hire purchase agreements.

8.18 The definition of "dealing as consumer" in section 12 and the reasonableness test in section 11 and Schedule 2 of the 1977 Act are almost identical to those in section 4, and section 3 and Schedule 2 of Cap 71 respectively.

Conclusion

8.19 In all the jurisdictions discussed above, there are provisions to control the operation of exemption clauses in the context of supply of goods other than sale. The extent of the control varies. In Australia, where the goods are not of a kind ordinarily acquired for "personal, domestic or household use or consumption", the liability of a supplier can be restricted to replacement of, repair of or the costs of replacing or repairing the goods. In New Zealand, the prohibition on contracting out does not apply where a consumer acquires or holds himself out as acquiring the goods for business, provided the agreement between the supplier and the consumer is in writing. The 1974 Act in Australia and the 1993 Act in New Zealand only apply to consumer transactions. Thus, exemption clauses on the statutory implied terms of these two Acts are of limited application.

Contracting out subject to the control of Cap 71

8.20 The control of exemption clauses in respect of supply of goods other than sale in England and Wales is similar to that in Hong Kong in respect of sale of goods (section 57 of Cap 26 and section 11 of Cap 71) and indeed other kinds of supply of goods (section 12 of Cap 71). With the enactment of the Recommended Legislation on implied terms on supply of goods other than sale, there should also be control on exemption clauses. Unless there is a good reason to deviate from the present control in section 12 of Cap 71 in respect of the terms implied by common law, the status quo should be maintained. We therefore recommend that there should be a provision similar to section 57 of Cap 26 in the Recommended Legislation in order to allow contracting out of any right, duty and liability, subject to the control of Cap 71.

Recommendation 21

We recommend that there should be a provision similar to section 57 of the Sale of Goods Ordinance (Cap 26) in the Recommended Legislation in order to allow contracting out of any right, duty or liability, subject to the control of the Control of Exemption Clauses Ordinance (Cap 71).

New sub-section (3A) be added to section 12 of Cap 71

8.21 A new sub-section (3A) was added to section 7 of the 1977 Act. As discussed above, the effect of the new sub-section (3A) is to make any exemption clause on the implied terms about title, etc in contracts for the transfer of property in goods void. There is no equivalent provision in Hong Kong. Similarly, any exemption clause on implied terms about title, etc in

contracts of sale of goods and hire purchase agreements will also be void because of section 6(1) (similar to section 11(1) of Cap 71).

8.22 On the other hand, exemption clauses relating to the statutory implied undertakings as to a right to transfer possession and an assurance of quiet possession in contracts of hire in the 1982 Act of England will still be governed by section 7(4) of the 1977 Act (similar to section 12(4) of Cap 71). The effect is that the exemption clause will not be void straightaway but will be subject to a "reasonableness" test.

8.23 Professor N E Palmer has observed that the provisions which deal with the protection of hirers' right of possession are markedly inferior to those governing transactions where property passes. He writes:

> *"it remains open to the bailor under section 7 of the Unfair Contract Terms Act 1977 (as amended) to exclude liability for breach of this condition, even in the case of a consumer hiring, provided that he can demonstrate that the exclusion clause satisfies the statutory requirement of reasonableness. Such an exclusion is not now possible [because of the new section 7(3A)] …in relation to the equivalent term as to title implied into contracts for the transfer of goods …. The same differentiation against hirers applies to the implied assurance of quiet possession …[H]ere again, the lessor can in theory exclude liability for breach of the term [provided the exemption clause is reasonable]; the transferor in equivalent circumstances cannot [because of section 7(3A), unless his liability is non-business liability]. …"*[1]

8.24 The Law Commission in England and Wales has considered why exemption clauses relating to the statutory implied undertakings as to a right to transfer possession and an assurance of quiet possession in contracts of hire are not void straightaway but subject to a "reasonableness" test. The Law Commission stated:

> *"The reason for the difference is that section 12 of the Sale of Goods Act 1893 was divided into two parts when it was amended by the Supply of Goods (Implied Terms) Act 1973 so as to allow the parties to provide either for the transfer of full title (the ordinary case) or for the transfer of such title as the seller or some third party may have. Thus, the seller can contract out of the obligation to transfer full title by stipulating for sale with a restricted title; but section 6 of the Unfair Contract Terms Act 1977 prevents him from excluding or restricting his obligations as to title in any other way. However, that Act could not make similar provision for other contracts of supply, because the common law, which governed such contracts, did not, it seemed, allow the supplier to choose between supplying the goods on*

[1] N E Palmer,"The Supply of Goods and Services Act 1982", (1983) 46 MLR 619, at p 624.

the basis that he had full title to the goods or on the basis that he had only restricted title. Instead, the approach of the common law was thought to be to imply undertakings as to title on the part of the supplier in contracts of supply but to allow the parties to contract out of them. This approach was reflected in the Unfair Contract Terms Act 1977 in that the Act permits continued reliance on exemption clauses affecting implied terms as to title in contracts of supply but, as part of its scheme of protection from unfair terms, it also subjects such clauses to a test of reasonableness."[2]

8.25 In England and Wales, a transferor and a bailor can transfer "only such title as he or a third person may have" in a contract for transfer of property in goods under section 2(3) of the 1982 Act and in a hire purchase agreement under section 8(2) of the 1973 Act respectively. However, there is no equivalent provision in the 1982 Act in respect of contracts of hire. This explanation by the Law Commission appears to answer the question raised by Professor Palmer.

8.26 With the enactment of the Recommended Legislation, there will be statutory implied terms about title, etc in contracts for the transfer of property in goods and hire purchase agreements. In Hong Kong, a transferor and a bailor will be able to transfer "only such title as he or a third person may have" in a contract for transfer of property in goods and in a hire purchase agreement respectively under the Recommended Legislation. There is no equivalent provision in the Recommended Legislation in respect of contracts of hire.

8.27 In addition, there is a similar provision in section 11(1) of Cap 71 in respect of sale of goods which makes any exemption clause relating to the implied terms about title, etc void. To make contracts for the transfer of property in goods and hire purchase agreements in line with this, a new sub-section (3A) should be added to section 12 of Cap 71. For the reasons mentioned above, there is no need, however, for such a sub-section to apply to contracts of hire. This new sub-section (3A) is needed in section 12 of Cap 71 in respect of contracts for the transfer of property in goods and hire purchase agreements and we so recommend.

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[2] Law Commission, Report on *Implied Terms in Contracts for the Supply of Goods,* Law Com No 95, 1979, at para 70.

Recommendation 22

We recommend that a new sub-section (3A) should be added to section 12 of the Control of Exemption Clauses Ordinance (Cap 71) to make any exemption clause relating to the implied terms as to title, etc in contracts for the transfer of property in goods and hire purchase agreements void. There is no need for such a sub-section to apply to contracts of hire.

Section 12 of Cap 71 be amended to cover agreements to transfer property in goods and agreements to bail goods

8.28 The Law Commission recommended a consequential amendment to section 7 of the 1977 Act in order to cover agreements to transfer property in goods and agreements to bail. The Law Commission stated:

> *"[W]e do recommend one other minor amendment to section 7 of the Unfair Contract Terms Act 1977. The provisions of the Sale of Goods Act model apply to all contracts of sale, and this expression includes both sales (where the property is transferred) and agreements to sell (where the property is to be transferred). The provisions of section 6 of the Unfair Contract Terms Act 1977 apply to clauses excluding or restricting liability in agreements to sell as well as sales. However, section 7 of the Unfair Contract Terms Act 1977 only refers to contracts under which 'possession or ownership of goods passes', and we recommend that it should be amended to include contracts under which possession or ownership are to pass, since contracts under which the property in goods is to be transferred are included in the scope of our proposals."*[3]

8.29 This recommendation was not reflected in the amended section 7 of the 1977 Act. In this Paper, the Recommended Legislation covers agreements to transfer property in goods (in contracts for transfer of property in goods) and agreements to bail goods (in contracts of hire). In addition, section 11 of Cap 71 applies to exemption clauses in agreements to sell and also sales. We are therefore of the view that the above recommendation of the Law Commission is appropriate and we so recommend.

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[3] Law Com No 95, 1979, at para 73.

Recommendation 23

We recommend that section 12 of the Control of Exemption Clauses Ordinance (Cap 71) should be amended to cover agreements to transfer property in goods and agreements to bail goods (in contracts of hire).

Chapter 9

Miscellaneous amendments concerning contracts for the sale of goods

Overview

9.1 In the preceding chapters, we discussed the terms to be implied in contracts for the supply of goods, the remedies for breaches of those terms and the exclusion of liability for such breaches. We discussed these matters in respect of various types of contracts for the supply of goods so as to bring them in line with contracts for the sale of goods.

9.2 Cap 26 also provides for a number of other matters relating to contracts for the sale of goods which are not necessarily relevant to other types of contracts for the supply of goods. In this chapter, we will discuss various issues concerning Cap 26, including sale of goods forming part of a bulk, right of partial rejection, the market overt rule, remedies for delivery of wrong quantity, acceptance of goods and the right to a reasonable opportunity of comparing the bulk with the sample. The relevant provisions in other jurisdictions on these matters prompt the present discussion. We will discuss the existing provisions in Cap 26 together with their associated problems and the experiences of other jurisdictions. After discussing the available options, we will present our recommendations.

9.3 The recommendations we make in this chapter are as follows:

(a) concerning sale of goods forming part of a bulk – **Recommendation 24**;
(b) providing for rights of partial rejection - **Recommendation 25**;
(c) abolishing the market overt rule - **Recommendation 26**;
(d) restricting rights of rejection on delivery of wrong quantity – **Recommendation 27**;and
(e) clarifying that asking for repairs not amount to acceptance of goods - **Recommendation 28.**

Sale of goods forming part of a bulk

Problems of the existing law

9.4 Section 18 of Cap 26 provides:

> *"Where there is a contract for the sale of unascertained goods no property in the goods is transferred to the buyer unless and until the goods are ascertained."*

9.5 The effect of section 18 is that a buyer of goods forming part of bulk cargoes or bulk storage does not obtain property to the goods until the goods are ascertained. The effect will be the same even if the buyer has paid the seller already. In the case of the insolvency of the seller, the buyer will become just an unsecured creditor while the goods and price paid by the buyer will pass to the office-holder in insolvency.

9.6 The effect of section 18 can be illustrated by a number of cases.[1] In *Re Wait*,[2] 500 tons of wheat from a cargo of 1000 tons, to be shipped from elsewhere, were sold and paid for. Before ascertaining the 500 tons, the seller became insolvent. It was held that because of section 16 of the 1979 Act (equivalent to section 18 of Cap 26), property in the 500 tons could not pass to the buyer before the goods were ascertained.

9.7 In *Re London Wine Co (Shippers) Ltd*,[3] specified quantities of wine were sold to various buyers but remained stored with the seller. There was no appropriation of the goods. Each buyer received a document certifying him as the beneficial owner of the goods and was charged storage and insurance. The seller became insolvent subsequently and it was held that property in the goods did not pass in any of the three types of transactions[4] before the goods were ascertained. Since there was no certainty of the subject matter, there was no trust. The certifying document and payment did not give rise to a proprietary interest.

9.8 These cases show that a buyer of goods forming part of bulk cargoes or bulk storage will not be able to obtain the goods on the seller's insolvency. This will be the same even though he has paid for the goods already in return for what he perceived to be a document of title such as a bill of lading. The buyer has paid for the goods, but yet loses the goods and becomes an unsecured creditor along with all others. This is unsatisfactory and unfair.

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1 The *Gosforth* case was the first case which alerted buyers of the effect of the section. Although it was a Dutch case, because of the choice of law clause in the contract, section 16 of the 1979 Act governed the contract of sale to the sub-buyers. The case illustrated that section 16 prevented property passing before the goods were ascertained.

2 [1927]1 Ch 606.

3 [1986] PCC 121.

4 First, a buyer purchased the total stock of a particular wine. Secondly, there were a number of buyers whose purchases exhausted the seller's stock of a particular wine held in different warehouses. Thirdly, there were a number of purchasers whose purchases did not exhaust the seller's stock.

9.9 Other unsatisfactory effects of section 18 include the fact that the section may also prevent property from passing to a buyer despite physical delivery of the goods to him.[5]

9.10 On the one hand, section 18 prevents property from passing; on the other hand, it does not prevent risk from passing to buyers. According to section 22 of Cap 26, the general rule is that risk passes with property, unless otherwise agreed.[6] For example, in *Sterns Ltd* v *Vickers Ltd*,[7] the Court of Appeal held that, whether the property had passed or not, upon acceptance of the delivery warrant, risk passed to the buyer. In international sales, the presumption in section 22 is usually rebutted. In a "free on board" (FOB) contract, risk passes to the buyer on shipment[8] while in a "cost insurance freight" (CIF) contract, risk passes to the buyer on or as from the time of shipment.[9] In other words, a buyer of goods out of a bulk may still have to bear the loss even if the goods are damaged or lost during transit. This means that on the insolvency of a seller, a buyer (B) of goods out of a bulk may lose his specified quantity of goods to an office-holder in insolvency even though he has paid for the goods already.

9.11 Furthermore, B does not have the title or interest to sue in tort for the damage to the goods,[10] even though he is the one to bear the loss of the goods. It is because a buyer cannot obtain legal ownership in, or possessory title to, the goods until the goods are ascertained. It is highly unsatisfactory and unfair that a statutory provision should lead to such consequences.

9.12 In commercial practice, sellers and buyers of goods out of a bulk usually want the property in the goods to pass when payment is made in return for documents, such as bills of lading. Section 18 does not allow the parties to do so and so defies commercial expectation and amounts to an obstacle to freedom of contract. Tom Burns has said in relation to section 16 of the 1979 Act that it was *"a mandatory rule which took no account of the intentions or expectations of the parties"*.[11] John Whisson has also said, *"[t]he*

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5 For example, a seller has a buyer (A) who agrees to distribute specified quantities out of bulk to other buyers. The seller then delivers the bulk to A who buys and pays for specified quantities out of the bulk which consists of goods to be distributed to other buyers. In such a case, the property of the goods does not pass to A even though the seller has delivered the bulk to him unless the specified quantities sold to A are separated from the bulk (ie ascertained).

6 "*[A]n agreement that one or other shall bear the risk may be inferred from their course of dealing, or by usage binding on both. The parties may agree that the risk shall pass only on delivery of the goods. Risk can clearly pass before property where the goods are specific or ascertained, although an intention that the buyer shall assume the risk before the property has vested in him must either be expressed or clearly inferred from the circumstances.*" See A Guest, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 6-003.

7 [1923] 1 KB 78.

8 *Stock v Inglis* (1884) 12 QBD 564, per Brett MR at p 573, affirmed by the House of Lords (1885) 10 App Cas 263.

9 *Comptoir d'Achat et de Vente du Boerenbond Belge S/A v Luis de Ridder Limitada (The Julia)* [1949] AC 293, at p 309 Lord Porter. See also *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 19-092: *"Lord Porter's statement contains two rules. Where the goods are sold and then shipped, the risk passes on shipment; but where they are already afloat at the time of sale it is more apposite to refer to the risk as having passed as from shipment …*".

10 *Leigh and Sillavan Ltd* v *Aliakmon Shipping Co Ltd* (The Aliakmon) [1986] AC 785.

11 Tom Burns, "Better Late Than Never: the Reform of the Law on the Sale of Goods Forming Part of a Bulk*"* (1996) 59(2) MLR 260, at p 261.

prohibition contained in s16 is indeed onerous and restrictive in respect of goods forming part of a bulk".[12]

9.13 It is useful to point out here that section 18 brought about another problem which has been solved. Because of section 2 of the repealed Bills of Lading Ordinance (Cap 45),[13] a person to whom goods were to be delivered under a contract for the carriage of goods by sea could not sue the carrier under the bill of lading for loss or damage to the goods before the property in the goods passed. This was particularly serious for sales of parts of bulk cargoes since section 18 of Cap 26 prevents the property from passing before the parts sold had been ascertained. Consequently, the buyer could not sue the carrier for the loss or damage even though he had paid for the goods and received a bill of lading.[14]

9.14 In 1993, the Bills of Lading and Analogous Shipping Documents Ordinance (Cap 440)[15] resolved this problem by providing that any lawful holder of a bill of lading has a right to sue the carrier. It stops making the passing of property in the goods as a prerequisite to sue a carrier under a contract of carriage. However, it only deals with one of the many problems brought about by section 18 and other problems remain to be resolved.

Experience in other jurisdictions

9.15 Before recommending ways to tackle the problems brought about by section 18 of Cap 26, it is helpful to examine the experiences in other jurisdictions. There are three categories:

(a) those with positions similar to Hong Kong (France and Italy);

(b) those requiring delivery to transfer property, but which allow substitutes for actual delivery (Germany and the Netherlands); and

(c) those with provisions for the passing of property in goods forming part of an identified bulk whereby a buyer becomes an owner in common (the United States and the United Kingdom).

9.16 According to the civil code of France, property in goods sold by weight, number or measure, does not pass until the goods are "individualised".[16] If the goods sold are specific goods, property passes once

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12 John Whisson "One Small Step for Judicial Man, One Giant Step for Consumer Kind?" (1995) 14 TrL 129 at p 130.

13 It was modelled on the English Bills of Lading Act 1855 and was regarded as a remedy to the common law principle that only the parties to a contract of carriage could sue or be sued under the contract.

14 This problem was not unique to bulk goods, but arose wherever property did not pass.

15 It was modelled on the Carriage of Goods by Sea Act 1992 of England & Wales which implemented the Law Commission report *"Rights of Suit in Respect of Carriage of Goods by Sea"*, Law Com No 196, 1991.

16 Civil code, art 1585; adopting the English translated text from *Sale of Goods Forming Part of a Bulk*, Law Com No 215; Scot Law Com No 145, 1993 at para 2.17.

the contract is made.[17] In Italy, property passes according to the parties' agreement in general, but where the goods sold are generic, property passes only *"on identification by agreement between the parties or in the manner established by them"*.[18]

9.17 In Germany, the general rule is that delivery is required for property to pass.[19] There are three exceptions. The first is when the buyer is in possession of the goods.[20] Secondly, where the seller is in possession, there may be substituted for delivery an agreed legal relationship between the parties, and the buyer will then obtain indirect possession.[21] Thirdly, where a third party is in possession, there may be substituted for delivery the seller's waiver to the buyer of his claim for delivery of the goods.[22]

9.18 Delivery is also required in general for property to pass in the Netherlands.[23] However, physical delivery is not required in certain situations, which are similar to those in Germany.[24]

9.19 In the United States, where goods sold are out of an identified bulk, a buyer of a specified quantity out of the bulk may acquire property in the goods as an owner in common. Section 2-105 (4) of the Uniform Commercial Code provides:

> *"An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common."*

9.20 In England, new sections 20A and B were added to the 1979 Act by the Sale of Goods (Amendment) Act 1995 which was prompted by the joint

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17 Civil code, art 1583.

18 Cod civ art 1378; adopting the English translated text from Law Com No 215; Scot Law Com No 145, 1993 at para 2.17.

19 *"For the transfer of the ownership of a moveable thing, it is necessary that the owner of the thing delivers it to the acquirer and that both agree that the ownership be transferred. If the acquirer is in possession of the thing, the agreement on the transfer of ownership is sufficient."* Article 929 of the civil code; adopting the English translated text from Law Com No 215; Scot Law Com No 145, 1993 at para 2.18.

20 Article 929 of the civil code.

21 *"If the owner is in possession of the thing, there may be substituted for delivery an agreed legal relationship between him and the purchaser, whereby the purchaser obtains indirect possession."* Article 930 of the civil code; adopting the English translated text from Law Com No 215; Scot Law Com No 145, 1993 at para 2.18. For example, the seller agrees to hold the goods on behalf of the buyer.

22 *"If a third party is in possession of thing, there may be substituted for delivery the owner's waiver to the acquirer of his claim for delivery of the thing."* Article 931 of the civil code; adopting the English translated text from Law Com No 215; Scot Law Com No 145, 1993 at para 2.18.

23 *"Transfer of property requires delivery pursuant to a valid title by the person who has the right to dispose of the property."* See Haanappel, *New Netherlands Civil Code: Patrimonial Law* (1990). Article 84, book 3, civil code; adopting the English translated text from Law Com No 215; Scot Law Com No 145, 1993 at para 2.19.

24 Article 115, book 3, civil code.

report of the English and Scottish Law Commissions.[25] According to section 20A(1) - (2),[26] a buyer, having paid for some or all of a specified quantity of goods forming part of an identified bulk, becomes an owner in common of the bulk despite section 16 (equivalent to section 18 of Cap 26). There are three conditions for this section to apply: (a) a specified quantity; (b) an identified bulk; and (c) a pre-paying buyer.

9.21 When the three conditions are satisfied, property in an undivided share passes to the buyer unless the parties agree otherwise. The buyer's share in the bulk as a co-owner is such share as the quantity bought and paid for by the buyer bears to the quantity in the bulk (section 20A(3)). The shares of a buyer fluctuate if there is any change in the bulk. Pursuant to section 20A(4), if the total of the undivided shares of all the buyers exceeds the whole of the bulk, each buyer's share is reduced proportionately. Where the buyer has paid for some of the goods only, any delivery out of bulk is to be ascribed first to the goods which have been paid for already (section 20A(5)).[27]

9.22 Section 20B has special provisions to facilitate normal trading. Each co-owner is deemed to consent to a delivery to other co-owners of that part of the bulk due to them under their contracts. He is also deemed to consent to any dealing with or removal, delivery or disposal of the goods in the bulk by any co-owner in respect of his undivided share (section 20B(1)). No cause of action shall lie against anyone who acted according to section 20B(1) relying on any such deemed consent (section 20B(2)). In addition, section 20B(3) preserves the contractual rights of buyers.[28]

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[25] *Sale of Goods Forming Part of a Bulk*, Law Com No 215; Scot Law Com No 145, 1993.

[26] Section 20A(1)-(2) reads as follows:

"(1) This section applies to a contract for the sale of a specified quantity of unascertained goods if the following conditions are met —

(a) the goods or some of them form part of a bulk which is identified either in the contract or by subsequent agreement between the parties; and

(b) the buyer has paid the price for some or all of the goods which are the subject of the contract and which form part of the bulk.

(2) Where this section applies, then (unless the parties agree otherwise), as soon as the conditions specified in paragraphs (a) and (b) of subsection (1) above are met or at such later time as the parties may agree —

(a) property in an undivided share in the bulk is transferred to the buyer; and

(b) the buyer becomes an owner in common of the bulk."

[27] Section 20A(3)-(6) provides as follows:

"(3) Subject to subsection (4) below, for the purposes of this section, the undivided share of a buyer in a bulk at any time shall be such share as the quantity of goods paid for and due to the buyer out of the bulk bears to the quantity of goods in the bulk at that time.

(4) Where the aggregate of the undivided shares of buyers in a bulk determined under subsection (3) above would at any time exceed the whole of the bulk at that time, the undivided share in the bulk of each buyer shall be reduced proportionately so that the aggregate of the undivided shares is equal to the whole bulk.

(5) Where a buyer has paid the price for only some of the goods due to him out of a bulk, any delivery to the buyer out of the bulk shall, for the purposes of this section, be ascribed in the first place to the goods in respect of which payment has been made.

(6) For the purposes of this section payment of part of the price for any goods shall be treated as payment for a corresponding part of the goods."

[28] Section 20B reads as follows:

"(1) A person who has become an owner in common of a bulk by virtue of section 20A above shall be deemed to have consented to —

9.23 On recommending sections 20A and B, the Law Commissions also made other recommendations incidental to the issue. Before the enactment of the 1995 Act, it was not certain whether a sale of an undivided share, specified as a fraction (such as 1/3 or 40%), in specific goods was a sale of specific goods. As recommended by the Law Commissions, the 1995 Act makes it clear that it is a sale of specific goods by adding words to that effect in the definitions of "goods" and "specific goods".[29] It adds "and includes an undivided share in goods" and "and includes an undivided share, specified as a fraction or percentage, of goods identified and agreed on as aforesaid" at the end of each of the definitions respectively. The Law Commissions have pointed out that the recommendations *"are not confined to undivided shares in bulk goods, but apply to undivided shares in any goods"*.[30] Sections 20A and B discussed above do not apply to sales of undivided shares. The shares of buyers in such sales are determined by their sale contracts, and the formula to determine the undivided shares in Sections 20A and B are not necessary, and indeed cannot apply to such sales. The Law Commissions said:

> *"The whole situation [of sales of undivided shares] is entirely different from that [of sales of specified quantities]. In the case of a sale of a specified quantity out of an identified bulk it is the quantity which is important: the reference to the bulk is just a way of partly ascertaining the goods covered by the contract. In the case of a sale of a share, such as a third or a half, of an identified bulk there is no mention of quantity at all and rules based on the quantity due to the buyer would be inappropriate."*[31]

Conclusion

Options

9.24 In France and Italy, as in Hong Kong, property in the goods cannot pass until the goods are ascertained. Therefore, the provisions in

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(a) any delivery of goods out of the bulk to any other owner in common of the bulk, being goods which are due to him under his contract;

(b) any dealing with or removal, delivery or disposal of goods in the bulk by any other person who is an owner in common of the bulk in so far as the goods fall within that co-owner's undivided share in the bulk at the time of the dealing, removal, delivery or disposal.

(2) No cause of action shall accrue to anyone against a person by reason of that person having acted in accordance with paragraph (a) or (b) of subsection (1) above in reliance on any consent deemed to have been given under that subsection.

(3) Nothing in this section or section 20A above shall —

(a) impose an obligation on a buyer of goods out of a bulk to compensate any other buyer of goods out of that bulk for any shortfall in the goods received by that other buyer;

(b) affect any contractual arrangement between buyers of goods out of a bulk for adjustments between themselves; or

(c) affect the rights of any buyer under his contract."

29 In section 61(1) of the 1979 Act.

30 Law Com No 215, at para 5.1.

31 Law Com No 215, at para 5.2.

these two countries are not particularly helpful to our present problem. In Germany and the Netherlands, delivery is generally required for property to pass, but it is not required in Hong Kong. Since the mechanisms are different, the provisions in these two countries are not of great assistance either. Consequently, there are four options available which are as follows:

(a) no change;
(b) amending section 18 of Cap 26;
(c) adopting a provision similar to section 2 - 105(4) of the Uniform Commercial Code of the United States; and
(d) adopting a provision similar to sections 20A and B of the 1979 Act of England.

9.25 We do not think that option (a) is realistic, given the concern and criticism which have been voiced at the various unsatisfactory effects of section 18 discussed above. In this connection, we would, however, welcome views, comments and suggestions from the commercial sector on this issue.

9.26 We do not favour option (b) for the following reasons. First, section 18 is regarded as sensible in general. Professor Goode has said, *"[s]uch a rule is inevitable, for one cannot speak of buying goods without knowing what one has bought."*[32] Secondly, the Law Commission has pointed out[33] that most traders in bulk goods usually have no specific intention as to when property is to pass. Thirdly, even if they have intended property to pass before ascertaining the goods, there are still unresolved questions, such as where several buyers have claims upon the goods, the question as to their respective interests.[34]

9.27 Option (c), section 2-105(4) of the Uniform Commercial Code can tackle the problems brought about by section 18 without amending or repealing it. However, the section is too brief and does not cover some important issues, such as the relationship between the quantity sold and the actual quantity of the bulk. The Law Commission has said in relation to the section:

> *"It will be seen that, unlike the Uniform Sales Act, the Uniform Commercial Code does not deal expressly with the relationship between the quantity sold and the actual size of the bulk. This could give rise to problems to which no clear solution has yet been propounded in any common law jurisdiction. In particular, what is to happen if the bulk in respect of which the undivided shares are held is in fact less than assumed? Is the buyer's share to abate in the proportion which the amount sold bears to the actual whole? This may not be known at the time of delivery to the various buyers of parts of the bulk. As a result, delivery may well be made to an earlier buyer of an amount, part of which actually belongs to the others. Unless special provision is*

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32 RM Goode, *Commercial Law*, 2nd Ed, 1995, at p 247.
33 *Right to Goods in Bulk* , Law Com, WP No 112, 1989, at para 4.6.
34 *Right to Goods in Bulk* , Law Com, WP No 112, 1989, at para 4.7.

made, the earlier buyer may then both be liable in conversion to a later buyer and unable to pass good title to a bona-fide third party, who would also be liable in conversion."[35]

9.28 Option (d) has attracted both support and criticism from commentators. We will deal with the criticisms first in the following paragraphs.

9.29 There are three major criticisms. First, the changes are said to be piecemeal and not extensive enough. Janet Ulph has said, *"it is merely a piecemeal reform and that an opportunity for a wider review of co-ownership and also the law of insolvency has been missed."*[36] But she immediately continues that the obvious response is *"that a more focused reform, such as this one, had a better chance of being enacted."*[37] Tom Burns finds that *"such piecemeal changes can lack coherence …[and] make the law difficult for users to access"*.[38] However, he then says that the 1995 Act *"has modernized the United Kingdom law and brought it into line with other jurisdictions."*[39] In his opinion, only codification can solve the issues and he knows that such a prospect seems remote. Professor Michael Bridge comments that *"an ad hoc reform of this nature …is no substitute for a root-and-branch review of the whole law of passing of property and title transfer."*[40] We are of the view that the implications of codification and review of the law of property passing are too far-reaching to be dealt with in this Paper.

9.30 The second major criticism is that the 1995 Act does not provide for the allocation of risks. Professor Guest finds that the Act is unclear as to the allocation of risks concerning an undivided share in a bulk.[41] Robert Bradgate and Fidelma White have also said, "*the absence of any provision dealing with the transfer of risk creates uncertainty and may lead to disputes*."[42] Janet Ulph also mentions that the 1995 Act is silent on the allocation of risks.[43] But she justifies that as a wise omission, since it would be too complicated to provide for every possible eventuality which would make it out of place with the rest of the 1979 Act. We will deal with the issue of risk separately later.

9.31 The third criticism is that the 1995 Act does not touch on a number of associated principles. Nevertheless, Janet Ulph finds that the Law

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35 *Right to Goods in Bulk*, Law Com, WP No 112, 1989, at para 4.9.

36 Janet Ulph, "The Sale of Goods (Amendment) Act 1995: Co-ownership and the Rogue Seller" [1996] LMCLQ 93, at p 106.

37 Janet Ulph, "The Sale of Goods (Amendment) Act 1995: Co-ownership and the Rogue Seller" [1996] LMCLQ 93, at p 106.

38 Tom Burns, "Better Late Than Never: the Reform of the Law on the Sale of Goods Forming Part of a Bulk" (1996) 59(2) MLR 260, at p 271.

39 Tom Burns, "Better Late Than Never: the Reform of the Law on the Sale of Goods Forming Part of a Bulk" (1996) 59(2) MLR 260, at p 271.

40 M Bridge, *The Sale of Goods*, 1997, at p 463.

41 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 6-006.

42 Robert Bradgate and Fidelma White, "Sale of Goods Forming Part of a Bulk: Proposals for Reform" [1995] LMCLQ 315, at p 322.

43 Janet Ulph, "The Sale of Goods (Amendment) Act 1995: Co-ownership and the Rogue Seller" [1996] LMCLQ 93, at p 106.

Commission's reluctance to consider equitable principles is sensible.[44] The Law Commission considered that equity was flexible and discretionary and was therefore inappropriate in a commercial context.[45] Janet Ulph finds it a legitimate concern since certainty is important in the commercial world. In addition, Louise Gullifer agrees with the Law Commission that the problems of possession *"are not important enough to warrant a complicated set of special provisions in the Act."*[46] This is because *"nearly all the problems can be solved without recourse to the concept of constructive possession"*.[47]

In favour of option (d)

9.32 Despite the criticisms, option (d) has its own merits. First, Professor Goode has suggested (before the enactment of sections 20A and B), following the American example to solve the problems brought about by section 16 of the 1979 Act and said:

> "*Section 2-105(4) embodies a sensible approach to co-ownership which meets business needs and abandons the technical, if logical, distinction between an unidentified part of a bulk and a proportionate interest in a bulk. We would do well to emulate the American example."*[48]

9.33 After the enactment of the two sections, Professor Goode has said, *"[t]he Law Commission advocated the adoption of a similar rule [to that in America] in England. …These recommendations have now been carried into effect by the Sale of Goods (Amendment) Act 1995"*.[49]

9.34 Sections 20A and B have generally been welcomed by academics. Robert Bradgate and Fidelma White have mentioned, *"[m]easured against their apparent objectives, the proposals [in the Law Commission report] seem generally attractive."*[50] In addition, Janet Ulph has said, *"[the new sections offer] a pragmatic solution to the particular needs of international traders, and must therefore be warmly welcomed."*[51] John Whisson said before the enactment of the new sections that the Law

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44 Janet Ulph, "The Sale of Goods (Amendment) Act 1995: Co-ownership and the Rogue Seller" [1996] LMCLQ 93, at p 106.

45 Law Com No 215, at para 4.33.

46 Louise Gullifer, "Constructive Possession after the Sale of Goods (Amendment) Act 1995" [1999] LMCLQ 93, at p 110.

47 Louise Gullifer, "Constructive possession after the Sale of Goods (Amendment) Act 1995" [1999] LMCLQ 93, at p 110.

48 R M Goode, "Ownership and Obligation in Commercial Transactions", (1987) 103 LQR 433, at 451.

49 R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 246. K J Brinkworth has also said that the recommendations of the Law Commission *"would bring the law in the UK into line with the US Uniform Commercial Code"*. See K J Brinkworth, "Bulk Revisited" (1995) 16 BLR 106, at p 107.

50 Robert Bradgate and Fidelma White, "Sale of Goods Forming Part of a Bulk: Proposals for Reform" [1995] LMCLQ 315, at p 322.

51 Janet Ulph, "The Sale of Goods (Amendment) Act 1995: Co-ownership and the Rogue Seller" [1996] LMCLQ 93, at p 106.

Commission report was *"a glimmer of hope for the future"*.[52] In David Brown's view:

> *"[the] Act is a welcome amendment to the law as regards bulk purchases, and results from a careful review and consultation exercise by the Law Commissions. It is suggested that the resulting legislation provides purchasers with some 'security' on the insolvency of a seller, whilst the officeholder is relieved of the burden of apportionment and the seller is relieved of undue storage costs."*[53]

9.35 Sections 20A and B of the 1979 Act, based on the same principle as their US counterpart, turn buyers of specified quantities from a bulk into tenants in common. Sections 20A and B have specific provisions to regulate the relationship between the quantity sold and the actual quantity of the bulk,[54] and the relationship between the co-owners themselves.[55] As discussed above, there is no such provision in the American counterpart, which was the reason for its being criticised by the Law Commission. It is these specific provisions which make option (d) more attractive than option (c). However, we seek views, comments and suggestion on this specifically. We now examine the conditions for these specific provisions to apply.

(a) conditions for the specific provisions to apply

9.36 There are three conditions: (a) a specified quantity; (b) an identified bulk; and (c) a pre-paying buyer. First, the section only applies to sales of specified quantities (for example, 1000 kg of grain) but not sales of shares (one-half or 30%)[56] of a bulk. Secondly, the specified quantity must be out of an identified bulk. One member of our Sub-committee has observed that it might be difficult for a consumer to identify the bulk from which he buys the goods. This is most likely to arise for purchases through the Internet. If the bulk is not identified, the proposed provision is unlikely to improve a consumer's position when the seller becomes insolvent.

9.37 It must be pointed out that sections 20A and B do not apply to a sale of generic goods, that is to say, a certain quantity of goods in general without any specific identification of them, such as two kg of Californian grapes. This is the way by which consumers usually purchase goods. The way of purchasing goods forming part of an identified bulk (such as 300 tons of wheat out of a cargo of 500 tons on board a certain ship) is more commonly adopted by business buyers. By their very nature, sections 20A and B are targeting business buyers. The majority of our Sub-committee find the condition as to "an identified bulk" sensible because it must be at least possible to identify the bulk from which the specified quantity comes.

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52 John Whisson, "One Small Step for Judicial Man, One Giant Step for Consumer Kind?" (1995) 14 TrL 129 at p 130.

53 David Brown, "Joint Wine, Joint Bottles, Fewer Cases? – The Sale of Goods (Amendment) Act 1995" (1996) 12 IL& P 52, at p 53.

54 Section 20A(3) - (6).

55 Section 20B.

56 We will deal with this under the next heading.

Property will not pass in totally unidentified goods. The parties can identify the bulk "either in the contract or by subsequent agreement". The 1995 Act defines "bulk".[57] The definition is intended to exclude a seller's general stock.[58]

9.38 Thirdly, the new section only applies to buyers who have paid for some or all of the goods. Buyers who have only paid for some of the goods would obtain a proportionate share. There have been criticisms of confining the new sections to pre-paying buyers. The existing law allows property to pass regardless of whether buyers have paid for the goods.[59] In addition, the new section allows a seller's insolvency officer to take advantage of market movements by choosing whether or not to perform the contract.[60] The rationale for confining the application of the section to pre-paying buyers is that *"this is sufficient to meet the injustice which needs to be remedied"*.[61] Buyers who have not paid still have their money. It is the pre-paying buyers who lose both their money and the goods. We therefore recommend that a buyer, having paid for some or all of a specified quantity of goods forming part of an identified bulk, becomes an owner in common of the bulk despite section 18 of Cap 26.

(b) buyers of the bulk as co-owners

9.39 When the three conditions are satisfied, property in an undivided share would pass to the buyer unless the parties agree otherwise. The buyer's share in the bulk as a co-owner is the proportion which the quantity bought and paid for by the buyer bears to the quantity in the bulk (section 20A(3)). The shares of a buyer fluctuate if there is any change in the bulk. If, for instance, a buyer (B) buys 100 kg of grain out of a bulk (1000 kg) from a seller (S), B's share is 10%. If the bulk is reduced to 500 kg because of, for example, delivery to another buyer, B's share becomes 20%. This is regarded as a "sensible"[62] approach. Once the bulk is reduced to 100 kg or less and B is the only buyer, B will own the whole bulk. This is the common law rule on ascertainment by exhaustion[63] and is reflected in section 18 rule 5 (3) introduced by the 1995 Act. Section 18 rule 5(4)[64] gives effect to a related

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57 *"'bulk' means a mass or collection of goods of the same kind which –*
(a) is contained in a defined space or area; and
(b) is such that any goods in the bulk are interchangeable with any other goods therein of the same number or quantity"

58 Law Com No 215, at para 4.3. See also Sheila Bone and Leslie Rutherford, "Sale of Goods: Changes to the Transfer of Ownership Rules" [1995] SJ 866, at p 866.

59 Law Com No 215, at para 4.6. See also Robert Bradgate and Fidelma White, "Sale of Goods Forming Part of a Bulk: Proposals for Reform" (1995) LMCLQ 315, at p 318.

60 *"If the price of the goods has dropped the seller will offer delivery of the goods and demand the price; but, if it rises, he will keep the goods and leave the buyer as an unsecured creditor with an unliquidated claim for damages."* Robert Bradgate and Fidelma White, "Sale of Goods Forming Part of a Bulk: Proposals for Reform" (1995) LMCLQ 315, at p 318.

61 Law Com No 215, at para 4.6.

62 Robert Bradgate and Fidelma White, "Sale of Goods Forming Part of a Bulk: Proposals for Reform" (1995) LMCLQ 315, at p 319.

63 *Re Wait and James v Midland Bank* (1926) 24 Ll L Reo 313; (1926) 31 Com Cas 172.

64 Section 18 rule 5(3) & (4) reads as follows:
"(3) Where there is a contract for the sale of a specified quantity of unascertained goods in a deliverable state forming part of a bulk which is identified either in the contract or by subsequent agreement between the parties and the bulk is reduced to (or to less than)

common law rule:[65] rule 5(3) also applies where under various contracts, there is one buyer of the remaining goods from a bulk which is reduced to(or to less than) the total quantities due to that buyer. Rule 5(3) and (4) applies whether or not a buyer has paid any part of the price unless there is a contrary intention that property is to pass only on payment of the price.[66] The addition of rule 5(3) and (4) has been well-received as giving *"statutory effect to well established common law developments"*.[67] Accordingly, we recommend adopting sections 20A (3) and 18 rule 5 (3) and (4).

9.40 Pursuant to section 20A(4), if the total of the undivided shares of all the buyers exceeds the whole of the bulk (which has been reduced) and all the buyers' entitlements cannot be satisfied, each buyer's share is reduced proportionately to each buyer's share in the original bulk. After the reduction, the total undivided shares of all the buyers will be equal to the whole remaining bulk. We will deal with section 20A(4) in greater detail in the paragraphs on the issue of risk later.

9.41 Section 20A (5) and (6) deals with the issues of part payment and delivery. Where the buyer has paid for some of the goods only, any delivery out of the bulk is to be ascribed first to the goods which have been paid for[68] (section 20A(5)). This is in line with the existing law since section 28 of the 1979 Act makes payment and delivery concurrent conditions. Section 20A(6) makes it clear that a part payment for any goods is to be treated as a payment for a corresponding portion of the goods.[69] This subsection is taken as confirming "what may be already assumed".[70] We recommend adopting section 20A(4)-(6).

(c) special provisions to facilitate normal trading and regulate obligations among co-owners

9.42 Section 20B has special provisions to facilitate normal trading and regulate obligations among co-owners. It must be pointed out that the co-ownership brought about by section 20A is a special type of co-ownership, *"in relationship to which the normal rules of co-ownership would be too*

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that quantity, then, if the buyer under that contract is the only buyer to whom goods are then due out of the bulk –

(a) the remaining goods are to be taken as appropriated to that contract at the time when the bulk is so reduced; and

(b) the property in those goods then passes to that buyer.

(4) Paragraph (3) above applies also (with the necessary modifications) where a bulk is reduced to (or to less than) the aggregate of the quantities due to a single buyer under separate contracts relating to that bulk and he is the only buyer to whom goods are then due out of that bulk."

65 *Karlshamns Oljefabriker v Eastport Navigation Corp (The Elafi)* [1982] 1 All ER 208.

66 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 5-103 n 21.

67 Sheila Bone and Leslie Rutherford, "Sale of Goods: Changes to the Transfer of Ownership Rules" [1995] SJ 866, at p 867.

68 If B agrees to buy 100 kg of oil out of a bulk of 1000 kg, and pays 40% of the contract price. He takes delivery of 10 kg and there remains 30 kg to be delivered to B.

69 B agrees to buy 100 kg of oil out of a bulk of 200 kg for $1,000, and pays the seller $400. The payment is taken as payment for a corresponding part of the goods ie 40%.

70 Sheila Bone and Leslie Rutherford, "Sale of Goods: Changes to the Transfer of Ownership Rules" [1995] SJ 866, at p 867.

restrictive".[71] Indeed, all the co-owners envisage that *"the bulk will be divided up in the normal course of events"*.[72] Co-owners are deemed to consent to a delivery to other co-owners of that part due to them under their contracts from the bulk even if the delivery would bring about or increase a shortfall (section 20B(1)(a)). This provision is necessary for clearing doubt and regulating relationships among co-owners as the Law Commission has pointed out:

> *"There are sound practical reasons for allowing deliveries to take place on a first come, first served basis. When deliveries begin the seller (or carrier, or warehouseman) may not know that there is likely to be a shortage. Moreover, it would often be impracticable to sort and apportion the goods. …There was weighty support on consultation for allowing deliveries in accordance with contracts on a first come, first served basis even in cases of shortfall or potential shortfall."*[73]

9.43 Co-owners are also deemed to consent to any dealing with or removal, delivery or disposal of the goods in the bulk by any co-owner in respect of his undivided share (section 20B(1)(b)). This provision is necessary as *"the co-owning buyers should be able to deal freely with the goods falling within their respective shares"*[74] in the same way as the seller can deal with his remaining share of the bulk. The Law Commission has pointed out that the deemed consents would not apply to over-sales by a seller who remains in possession of the goods or documents of title to the goods, bringing in new co-owners when the bulk is already insufficient for the existing co-owners.[75] This is because the deemed consent in section 20B(1)(b) applies only where the goods disposed fall within the undivided share of the co-owner (ie seller) at the time of the disposal. Section 20B(2) further provides that no cause of action shall lie against anyone who has acted according to section 20B(1) relying on any such deemed consent. This is necessary to protect insolvency office-holders, warehousemen, carriers, etc who, relying on the deemed consents, may have to deal with the goods.

(d) preserving buyers' contractual rights

9.44 Section 20B(3) clarifies three matters. First, there is no obligation on buyers who take delivery out of the bulk to compensate other buyers who may receive less than their contractual quantities (section 20B(3)(a)). This is justifiable, as under the existing law buyers are not liable to compensate other buyers for short deliveries who can still claim against the seller. In addition, there are practical difficulties in putting this type of compensation scheme in practice and into a statutory rule as the Law Commission has mentioned:

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71 Law Com No 215, at para 4.15.
72 Law Com No 215, at para 4.15.
73 Law Com No 215, at para 4.17.
74 Law Com No 215, at para 4.16.
75 Law Com No 215, at para 4.18. The Law Commission continued to mention that the position was covered by section 24 of the 1979 Act (equivalent to section 27(1) of Cap 26).

"The weight of argument on consultation was clearly in favour of having no statutory rule requiring one buyer to account to others where deliveries were made in the normal course of trading. … It would be highly inconvenient if, in cases not covered by mutually agreed adjustment schemes, this were to be changed. The first buyer has no control over what happens to the bulk and may have no knowledge of the existence of later buyers. Claims might arise long after the first delivery, particularly in the case of goods stored on land. There could be severe difficulties of proof and the net result of a great deal of inconvenience and dispute would, at best, be the replacement of one claim for damages against a seller by several lesser claims."[76]

9.45 Secondly, despite section 20B(3)(a), there is nothing to prevent the parties agreeing among themselves to any adjustment scheme (section 20B(3)(b)). This is to preserve the parties' freedom to deal with the matter of short delivery. Thirdly, nothing in section 20A or B affects a buyer's rights against the seller under their contract. This is to put beyond doubt that a buyer retains his usual rights against the seller, for example, concerning defective goods or short delivery. For the reasons mentioned above, we recommend adopting section 20B.

(e) application to international sales

9.46 Professor Treitel has pointed out that there may be difficulties in applying sections 20 A and B to international sales. First, section 20A(1)(a) requires the bulk to be "*identified either in the contract or by subsequent agreement between the parties*". It is not clear whether an identification of the bulk by a notice (for example, a notice of appropriation[77]) given by the seller (which is common in international sales) would suffice. Professor Treitel has said:

"Where the contract requires the seller to give a notice of appropriation, it can be argued that the buyer has assented in advance to whatever appropriation the seller may make, so long as it satisfies the requirement of the contract; but even if this argument is accepted, the buyer's advance assent given in the contract can hardly be evidence of a 'subsequent agreement'. It is even harder to find evidence of subsequent agreement where the contract contains no provision as to notice of appropriation and the seller, after the making of the contract, simply gives

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[76] Law Com No 215, at para 4.20.

[77] It must be pointed out that "notice of appropriation" is not a term of art, and it may be, in practice, a bill of lading or other shipping documents identifying the specific bulk from which a part is being sold to the buyer. "*The contract of sale may expressly require the seller to give a notice of appropriation, or to 'declare' a shipment made under the contract, or to give a 'notice of nomination', (ie one declaring the name of the ship carrying the goods which he has appropriated to the contract)".* G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 19-017. At para 19-022, he continued to say, " …*it means that a cif seller 'generally' has to give notice because the contract will generally contain a provision to that effect. Where the contract is silent on the point, the seller is not, it is submitted, bound to give notice of appropriation*."

such a notice. So long as the notice is valid, the buyer has no choice in the matter: if the seller validly appropriate goods on the Peerless I, the buyer cannot object merely because he would have preferred goods on the Peerless II. Such cases are hard to bring within the literal meaning of the words of section 20A(1)(a)"[78]

9.47 In a typical CIF contract, a seller will usually be under an obligation to notify[79] the buyer of the particulars of the shipment, such as, the particulars of the vessel carrying the goods which are appropriated to the contract, the date of the shipment, etc. This is the time when identification of the bulk arguably takes place. In a FOB contract, a seller will usually tender the bill of lading or other shipping documents to the buyer for payment.[80] This may also be the time when identification of the bulk takes place.[81] Professor Treitel has pointed out that if the reported cases are any guide, it is uncommon for FOB sellers to ship goods in bulk in order to perform contracts with more than one buyer.[82] Therefore, sections 20A and B will only rarely apply to FOB contracts.

9.48 For the avoidance of doubt, there may be a need to expressly cover such subsequent identifications in accordance with a seller's express or implied obligation under a sale contract, and we recommend accordingly.

9.49 Secondly, section 20A(1)(b) requires that a buyer must have "*paid the price for some or all of the goods which are the subject of the contract and which form part of the bulk*". There is little difficulty in applying this to cases where payments are in cash. But in international sales, payments are more commonly made by documentary bills[83] or documentary credits.[84] Professor Treitel has said:

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78 G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 18-235.

79 He can do that by tendering a bill of lading or other shipping documents amounting to a "notice of appropriation" notifying the buyer of a particular bulk as mentioned by Professor Treitel.

80 In a FOB contract, it is usually the buyer who nominates a vessel to carry the goods, and therefore, he should have the particulars of the shipment already.

81 But in a FOB contract, identification of the bulk may take place as early as when the seller places on board the goods appropriated to the contract since in this type of contract, it is the buyer who nominates the vessel. Once the seller has put the bulk appropriated to the contract on board the nominated vessel, he may not be able to change his mind and appropriate some other bulk on (say) other vessel.
Professor Treitel is also of the view that there is an identification of the bulk by subsequent agreement when a seller puts the goods on board the ship in response to the shipping instructions given by the buyer. G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 20-073.

82 It is more common for CIF sellers to divide bulk shipments which are already afloat between two or more buyers. G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 20-073.

83 "*A 'documentary bill' is a bill of exchange to which shipping documents are attached. Where a contract of sale provides for payment by acceptance of seller's draft in exchange for shipping documents, the seller may send to the buyer a bill of exchange together with the bill of lading, and possibly other shipping documents, in order to obtain the buyer's acceptance of the bill of exchange. In such a case the buyer is under a contractual obligation to accept the bill of exchange*." G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 18-168.

84 "*Though the seller who stipulates for acceptance or payment against documents has some measure of security, he is not fully protected, for by that stage he has incurred the expense of manufacturing or acquiring the goods and shipping them to the buyer's country, and if the bill is dishonoured the seller will be left with the goods on his hands and will have the trouble and expense of disposing of them elsewhere. What the seller needs is an assurance, before he*

"Where the contract provides for payment in one of these ways, property in ascertained goods can pass on acceptance of a draft by the bank or on acceptance of the bill of exchange by the buyer, even though that acceptance is subsequently dishonoured by non-payment;[85] *but in the case of a contract for the sale of a specified quantity out of a bulk, if this method of payment is adopted, and fails, then it seems that the case would not be one in which 'the buyer ha[d] paid the price' within section 20A(1)(b). The same may be literally true if payment under a documentary credit is made by the bank; but even if such a case is not literally one in which 'the buyer has paid the price', it is clearly one in which payment had been made on his behalf, and such a payment should, it is submitted, suffice for the purpose of section 20A(1)(b)."*[86]

9.50 He is of the opinion that if the price is paid outright,[87] even though it is made by a bank on behalf of a buyer, it falls within section 20A(1)(b). But if payment is made by a documentary bill which is a term bill[88] and the buyer has accepted the bill in exchange for the shipping document, problems will arise where subsequently the buyer has dishonoured by non-payment.[89] Professor Treitel has said that the buyer has not "paid" for the purpose of section 20A(1)(b). As mentioned in the above quotation, if the goods are ascertained goods, Professor Treitel is of the view that property in the goods will still pass.[90] He has not further explained but has referred to para 18-170[91] which states:

"[s]ection 19(3) [equivalent to section 21(3) of Cap 26] says that the buyer must return the bill of lading if he 'does not honour the bill of exchange.' A bill of exchange may be dishonoured in two ways, by non-acceptance and by non-payment; and section 19(3) does not expressly say which of these kinds of dishonour it contemplates. The reasoning of the Privy Council in The Prinz Adalbert[92] *however, suggests that it is dishonour by non-acceptance which is the crucial factor in preventing the passing of property. … In that case Lord Sumner considered the position ..[that['If the shipper, being then owner of the goods,*

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makes the shipping arrangements, that he will be paid after shipment. It is this need that the documentary credit is designed to satisfy." R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 962.

85 He has not further explained but has referred to para 18-170. The relevant extract of para 18-170 is quoted in the following paragraph.

86 G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 18-235.

87 For example, a buyer pays in exchange for a shipping document where the bill of exchange is a sight bill under which a buyer pays in exchange for a shipping document.

88 Under a term bill, a buyer accepts the bill of exchange first in exchange for a shipping document and pays later.

89 G Treitel, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 18-170.

90 It seems that Professor Goode also has similar view. "*Where the documents are accompanied by a draft on the buyer, the property does not pass until he accepts and returns the draft (Sale of Goods Act, s19(3))*." R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 950 n 85.

91 See also para 19-085 at p 1316 and para 20-072.

92 [1917] AC 586.

authorizes and directs the banker … to surrender the bill of lading against acceptance of the draft, it is natural to infer that he intends to transfer the ownership when this is done, but intends also to remain the owner until this has been done. ...' A seller who wants to retain the property until the draft is actually paid can of course include a stipulation to this effect in the contract, or achieve the same result by providing that payment must be by cash against bill of lading."[93]

9.51 Similar problems can arise when payment is made by documentary credit. A documentary credit is basically a banker's assurance of payment against presentment of specified documents. In international sales, almost all documentary credits are expressed to be subject to the Uniform Customs and Practice for Documentary Credits (the "UCP") published by the International Chamber of Commerce.[94] Article 2 of the UCP defines a documentary credit as follows:

"any arrangement, however named or described, whereby a bank (the 'Issuing Bank') acting at the request and on the instructions of a customer (the 'Applicant') or on its own behalf,

(i) is to make a payment to or to the order of a third party (the 'Beneficiary'), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary, or

(ii) authorises another bank to effect such payment or to accept and pay such bills of exchange (Draft (s)), or

(iii) authorises another bank to negotiate,

against stipulated document(s), provided that the terms and conditions of Credit are complied with."

9.52 In essence, by an arrangement with an applicant (a buyer), a bank is (i) to make a payment to the beneficiary of the arrangement (the seller), (ii) to accept and pay a bill of exchange drawn by the seller, or (iii) to authorise another bank to do either (i) or (ii) or to negotiate (ie purchase) the stipulated documents.[95] There is no problem if the bank pays the seller outright, but if the bank accepts or authorises another bank to accept a bill of exchange, or authorises another bank to purchase the stipulated documents, there may be default in payment subsequently. In this case, according to Professor Treitel, the buyer may not be regarded as having "paid" for the purpose of section 20A(1)(b).

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93 Lord Cairns, LC also stated that acceptance of the bill of exchange in exchange for the bill of lading operated to transfer the property in the goods. *Berndston v Strang* (1868) LR 3 Ch App 588, at p 590.

94 R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 962.

95 R Jack, *Documentary Credits*, 2nd Ed, 1993, at para 1.33.

9.53 According to Professor Treitel, by applying the reasoning of the Privy Council in "*The Prinz Adalbert"* case, in the case of ascertained goods, it is the acceptance of a bill of exchange which is crucial to the passing of property. We are of the view that such reasoning should also apply to a sale of a specified quantity out of an identified bulk so as to tackle the problems concerning the requirement of having "paid" in respect of payment by documentary credit and documentary bill as mentioned by Professor Treitel. The spirit of sections 20 A and B is to protect pre-paid buyers against sellers' insolvency. The requirement of having "paid" in sections 20A and B should not be a hindrance to applying the reasoning in "*The Prinz Adalbert"* case to a sale of a specified quantity out of an identified bulk if Cap 26 has expressly provided for it. A balance has to be struck between protecting buyers on the one hand and sellers on the other. Furthermore, if a seller wants to retain the property until he is paid, he can stipulate that in the contract as stated by Lord Sumner in "*The Prinz Adalbert"* case. We accordingly recommend that the requirement of having "paid" in sections 20A and B should be treated as having been fulfilled if (a) a buyer has accepted a bill of exchange under a documentary bill; or (b) the relevant bank has accepted a bill of exchange or has purchased the stipulated documents under a documentary credit, regardless of whether there is any default in payment subsequently.

9.54 Thirdly, section 20A(6) provides that a part payment for any goods is to be treated as a payment for a corresponding portion of the goods. Professor Treitel has said that the application of this rule to international sales may "give rise to an incongruous result".[96] This is because in such sales, the normal position is that property does not pass (since it is not intended to pass) until the price has been fully paid. For example, in an international sale, if a buyer buys the entire bulk but pays only part of the price, he will normally at this stage obtain no property at all. Professor Treitel has doubted why section 20A should put a buyer of an undivided share in a better position than one who buys the whole. But he justified the provision as follows:

> "*The policy of the 1995 reforms is to protect the buyers while the prima facie common law rule stated above is based on the converse policy of protecting the seller against the risk of the insolvency of the buyer. The rule laid down by section 20A for cases of part payment appears to achieve a satisfactory compromise between these two policies. In proportioning the buyer's proprietary interest to the amount of his payment, it satisfactorily protects each party against the risk of the other's insolvency. This statutory solution applies in terms only where the specified quantity sold forms 'part of a bulk' and cannot therefore displace the common law rule which prima facie applies where the whole bulk is sold to the same buyer. But the fact that the compromise is a satisfactory one is at least a plausible ground for arguing that, where the goods form part of a bulk, the statutory compromise which applies in cases of part payment for the quantity bought, should not be displaced merely*

[96] G Treitel, *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 18-237.

> *because the contract is on c.i.f. or f.o.b. terms and because in such sales property prima facie passes only on payment in full. It could of course be displaced by other evidence of contrary intention: eg by an express term that property should pass only on payment in full.*"[97] (emphasis added)

9.55 We agree that the provision on part payment is a sensible balance. It applies only where the conditions of section 20 are fulfilled (such as "part of a bulk") and therefore, will not affect the case where a buyer buys the entire bulk. Since the parties can contract out of the application of section 20A, the provision on part payment should not be excluded solely because it is an international sale on CIF or FOB terms. An express term excluding the provision on part payment is required. We therefore make no recommendation concerning this remark by Professor Treitel.

(f) risk

9.56 Section 22 of Cap 26 provides the general rule that risk passes with property, unless otherwise agreed. This general rule presumably also applies to a sale of a specified quantity of unascertained goods forming part of an identified bulk.[98] But some academics are of the view that the matter is complicated by section 20B(3)(c) which provides that nothing in sections 20 A and B shall "affect the rights of any buyer under his contract." Professor Guest has said:

> *"[o]n one view this saving provision leads to the conclusion that, in deciding whether or not the risk has passed to the buyer in goods not yet separated from bulk, the passing of property under section 20A is to be wholly disregarded and that the allocation of risk is to be determined without reference to the effects of that section.*"[99]

9.57 But he immediately states:

> *"[o]n another view, however, the purpose of the saving provision is simply to make it clear that the rights of the buyer, eg to sue for damages for non-delivery of the contract goods, are preserved and not to provide that section 20A should be left out of account in determining risk. The latter view is, it is submitted, the better one."*

9.58 We agree that the latter view is more justifiable, especially since risk concerns liabilities, not rights. The legislative intent of section 20B(3)(c) can be found in the Law Commission report[100] which mentions a buyer's

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97 G Treitel, *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 18-237.

98 A Guest, *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 6-006. See also "Sale of Goods Forming Part of a Bulk: Proposals for Reform" Robert Bradgate and Fidelma White [1995] LMCLQ 315, at p 321.

99 A Guest, *Benjamin's Sale of Goods* 5th Ed 1997 at para 6-006.

100 "*The interim co-ownership of the bulk is intended to be without prejudice to the buyers' contractual rights. They would still be entitled to delivery of goods which conformed to the*

entitlement to have goods which conform to the contract in quantity and quality when considering a buyer's "contractual rights". In addition, as section 20B(3)(c) preserves a buyer's rights under his contract, this should be understood in the context of the existing law. Under the existing law, a buyer may be subject to the passing of risk, regardless of his rights in the goods.

9.59 As mentioned above, in the opinion of Robert Bradgate and Fidelma White, the absence of any provision on risk creates uncertainty. Section 20B(3)(c) reserves a buyer's rights under his contract, including his entitlement to have goods of merchantable quality. But where a person agrees to buy goods forming part of a bulk, the risk of loss or damage may pass before his goods are separated. They accordingly doubt whether section 20B(3)(c) is adequate to preserve a buyer's rights. We would point out, however, that according to Professor Atiyah, risk is concerned with "*accidental destruction or deterioration and … damage to the goods [not] caused by the fault of either party*."[101] If the goods are destroyed or damaged by the seller's fault, the buyer can still claim against the seller even though risk has passed. Both common law[102] and statute[103] require the goods sold to be durable. Professor Atiyah accurately summarises the law when he states that "*the goods, when delivered, should have the capacity to remain reasonably fit for the purpose, and retain their non-functional attributes, for a reasonable time*."[104] If the goods deteriorate at an unreasonably fast rate, the buyer may claim against the seller for breaching the implied term on merchantable quality despite the passing of risk.

9.60 Professor Guest has said that the question of risk is not susceptible of an easy solution.[105] On the one hand, it can be argued that risk should pass only when the property in full (not just an undivided share) passes. On the other hand, Professor Guest finds it remarkable that a seller should continue to bear the risk, even though the property of the undivided share has passed and he is no longer the owner.

9.61 Professor Guest believed that the court may adopt the opinion of Scrutton LJ: "*the transfer of the undivided interest carries with it the risk of something happening to the goods*".[106] This is in line with the general rule in section 22: risk follows property, unless otherwise agreed. We have therefore come to the conclusion that it is fair for a buyer to bear the risk when the property of the undivided share passes to him. Undoubtedly, despite this general rule, the parties should be free to specify their own arrangement as to the allocation of risk. We conclude that there is no need to have a separate provision on risk.

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contract in quantity and quality. We recommend that this should be made clear in the legislation." Law Com No 215, at para 4.34.

101 PS Atiyah, *Sale of Goods*, 9th Ed, 1995, at p 305.

102 *Mash and Murrell v Joseph I Emmanuel* [1961] 1 All ER 485; *Lambert v Lewis* [1982] AC 225.

103 Durability is one of the elements of "satisfactory quality" and "merchantable quality" in section 14(2B) of the Sale of Goods Act 1979 and section 2(5) of Cap 26 respectively.

104 PS Atiyah, *Sale of Goods*, 9th Ed, 1995, at p 155.

105 A Guest, *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 6-006.

106 *Sterns Ltd v Vickers Ltd* [1923] 1 KB 78, at p 84 (with whom Eve J agreed).

9.62 The remaining question is how risk should be allocated if only part of the bulk is lost or destroyed. Professor Guest has argued[107] that a seller and his buyers should bear the *pro rata* share of the risk if the seller retains some shares of the bulk.[108] If the seller has not retained any share, the buyers should bear the risk *pro rata* to the extent of each of their shares in the bulk. Other writers have taken contrary views.[109] They suggest that a seller should first bear the risk to the extent of the shares he retains in the bulk, before a buyer begins to assume any risk.

9.63 We are of the view that section 20A(3) and (4)[110] has provided for the above question. The Law Commission has explained its effect as follows:

> *"… the buyers' shares accurately reflect the quantities purchased …and the seller's share reflects what is left. …the effect of the formula is that the risk of partial destruction of the goods rests with the seller (in the absence of agreement to the contrary) so long as the quantity destroyed is within the quantity retained by the seller."*[111]

9.64 The following example can illustrate the effect. In scenario 1, B1 and B2 respectively buy 400 kg and 200 kg of beans out of a bulk of 1000 kg from S. In scenario 2, 400 kg are lost and the bulk is reduced to 600 kg while in scenario 3, a further 300 kg are lost and the bulk is reduced to 300 kg. The quantities held, undivided shares and shares of the risk of S, B1 and B2 would be as follows:

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107 A Guest, *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 6-008.

108 Professor Treitel has also said: "*[t]he pro rata solution derives some support from the fact that it is adopted by the Sale of Goods Act 1979 section 20A(3) with regard to the passing of property in undifferentiated parts of a bulk which have been bought by several buyers*." *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 18-246.

109 Sheila Bone and Leslie Rutherford, "Sale of Goods: Changes to the Transfer of Ownership Rules" [1995] SJ 866, at p 867. See also Tom Burns, "Better Late than Never: the Reform of the Law on the Sale of Goods Forming part of a Bulk" (1996) 59(2) MLR 260, at p 268.

110 *"(3) Subject to subsection (4) below, for the purposes of this section, the undivided share of a buyer in a bulk at any time shall be such share as the quantity of goods paid for and due to the buyer out of the bulk bears to the quantity of goods in the bulk at that time.*
(4) Where the aggregate of the undivided shares of buyers in a bulk determined under subsection (3) above would at any time exceed the whole of the bulk at that time, the undivided share in the bulk of each buyer shall be reduced proportionately so that the aggregate of the undivided shares is equal to the whole bulk."

111 Law Com No 215, at para 4.14.

	Scenario 1		Scenario 2			Scenario 3		
	Quantities held	Undivided shares	Quantities held	Undivided shares	Shares of risk	Quantities held	Undivided shares	Shares of risk
S	400 kg	400/1000	-	-	400 kg[112]	-	-	400 kg
B1	400 kg	400/1000	400 kg	400/600[113]	-	200 kg	200/300[114]	200 kg[115]
B2	200 kg	200/1000	200 kg	200/600	-	100 kg	100/300	100 kg
Loss	-	-	400 kg	-	-	700 kg	-	-
Total	**1000 kg**	**1000/1000**	**600 kg**	**600/600**	**400 kg**	**300 kg**	**300/300**	**700 kg**

9.65 It is fair for S to bear the risk first since B1 and B2 have paid for their undivided shares. As long as the quantity lost, damaged, etc is within that retained by S, he should be the first to assume the liability. The Law Commission has said that the co-ownership brought about by section 20A is a special type, in relation to which the normal rules of co-ownership may not be appropriate.[116] We therefore make no particular recommendation on the matter of risk.

Recommendation 24

We recommend that provisions on sales of a specified quantity of unascertained goods forming part of an identified bulk similar to those in section 18 rule 5(3) and (4) and sections 20A and B of the English Sale of Goods Act 1979 should be made in Cap 26, namely:

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112 As explained in the following footnote, there is no need to reduce proportionately the undivided shares of B1 and B2 under section 20A(4) and B1 & B2 are entitled to 400/600 and 200/600 undivided shares respectively according to section 20A(3). The effect is that S bears the total risk since there is no need to reduce the undivided shares of B1 & B2, and the quantity lost is just within the quantity retained by him as explained by the Law Commission.

113 According to section 20A(3), the undivided share of B1 at any given time is such share as the quantity paid for and due to him bears to the total quantity of the bulk at that time. The total quantity of the bulk at that time is 600 kg since 400 kg has been lost. The same principle applies to B2. Section 20A(4) applies only when the aggregate of the undivided shares of B1 and B2 exceeds the whole of the bulk at the given time. In scenario 2, the aggregate of the undivided shares of B1 and B2 is 600 which is just equal to the whole of the bulk (600). Therefore, there is no need to reduce proportionately the undivided shares of B1 and B2.

114 The general rule in section 20A(3) is subject to section 20(4). In scenario 3, the aggregate of the undivided shares of B1 and B2 is 600 which exceeds the whole of the bulk (300) since 700 kg has lost. Therefore, section 20(4) applies and the undivided shares of B1 and B2 have to be reduced proportionately.

115 The loss exceeds the quantity retained by S. As explained in the above footnote, section 20A(4) applies and the undivided shares of B1 and B2 have to be reduced proportionately. The effect is that B1 and B2 bear the risk proportionately even though S is still required to bear the risk as to the first 400 kg.

116 Law Com No 215, at para 4.15.

(a) where the goods or some of them form part of a bulk identified in the contract or by subsequent agreement between the parties or by subsequent conduct of the seller in accordance with the terms of the contract, and a buyer has paid for the goods or some of them, unless otherwise agreed, property in an undivided share in the bulk passes to the buyer who becomes an owner in common;

(b) the undivided share of a buyer in a bulk at any time shall be such share as the quantity paid for and due to the buyer bears to the quantity of bulk at that time, provided that where the aggregate of the undivided shares of all the buyers exceed the whole of the bulk, the undivided share of each buyer shall be reduced proportionately so that the aggregate is equal to the whole bulk;

(c) where a buyer has only paid for some of the goods out of a bulk, any delivery shall first be ascribed to the goods which has been paid for;

(d) part payment for any goods shall be regarded as payment for a corresponding part of the goods;

(e) a buyer shall be deemed to have paid for the goods or some of them if (a) he has accepted a bill of exchange under a documentary bill; or (b) the relevant bank has accepted a bill of exchange or has purchased the stipulated documents under a documentary credit, regardless of whether there is any default in payment subsequently;

(f) where the goods are in a deliverable state and the bulk is reduced to (or to less than) the quantity sold to a buyer, and the buyer is the only buyer to whom goods are due out of the bulk, (i) the remaining goods are taken as appropriated when the bulk is so reduced, and (ii) the property in those goods passes to the buyer;

(g) the above paragraph applies where a bulk is reduced to (or to less than) the aggregate quantities due to a buyer under separate contracts relating to that bulk and he is the only one to whom goods are due out of that bulk;

(h) anyone who has become an owner in common of a bulk shall be deemed to have consented to (i) any delivery to any other co-owner of goods due to him out of the bulk, and (ii) any dealing with or removal, delivery or disposal by any other co-owner of goods out of the bulk provided the goods are within his undivided share;

(i) no cause of action shall accrue to anyone against a person by reason that the latter has acted in reliance on the above consents in the above paragraph;

(j) nothing in above shall:

- **require a buyer to compensate other buyers for any shortfall;**
- **affect any arrangement on adjustments among buyers themselves;**
- **affect any buyer's rights under his contract;**

(k) a "bulk" means a mass or collection of goods of the same kind which (a) is contained in a defined space or area; and (b) is such that any goods in the bulk are interchangeable with any other goods therein of the same number or quantity.

Extending the definitions of "goods" and "specific goods" to cover undivided shares of goods

9.66 As mentioned above, the 1995 Act of England, prompted by the Law Commission Report,[117] makes it clear that a sale of an undivided share, specified as a fraction (such as 1/3 or 40%), in specific goods is regarded as a sale of specific goods. To achieve this, the 1995 Act extends the definitions of "goods" and "specific goods".[118]

9.67 The Law Commission stated in the Report[119] that the purpose of extending the two definitions was to remove doubts. The Law Commission had two main arguments for recommending the inclusion of "an undivided share" in the definition of "goods". First, section 2(2) of the 1979 Act recognises that there may be a contract of sale between one part owner and another. Therefore the Law Commission has reckoned that it may be "the

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117 Law Com No 215.

118 In section 61(1) of the 1979 Act. It adds "and includes an undivided share in goods" and "and includes an undivided share, specified as a fraction or percentage, of goods identified and agreed on as aforesaid" at the end of the definitions of "goods" and "specific goods" respectively.

119 Law Com No 215, at para 5.1.

natural implication", in its context, from section 2(2) that "an undivided share" should be included in the definition of "goods".[120] Secondly, the Law Commission argued that an undivided share in goods was intended to be within the 1979 Act.[121] It cited *Van Cutsem v Dunraven*[122] and *Marson v Short*[123] as the authorities.

9.68 The Law Commission's argument for extending the definition of "specific goods" was that where there was a sale of an undivided share of specific goods, for example a horse, it would be inconvenient if the undivided share was regarded as unascertained goods.[124] It would be absurd that, in the case of goods which could not be divided without losing its identity, property in the share could never pass.[125]

9.69 In the following paragraphs, we will first discuss the Law Commission's arguments for extending the two definitions. This amounts to a discussion of the legal position before the 1995 Act since the Law Commission based its arguments on the existing law at that time. This also reflects the existing position of Hong Kong, which is the same as that in England before the 1995 Act.

9.70 As to the Law Commission's first argument for extending the definition of "goods", Professor Goode is of the view that section 2(2) of the 1979 Act only applies where a co-owner transfers his whole interest.[126] On the other hand, Professor Sealy has said that section 2(2) also applies where a co-owner transfers only part of his interest.[127] He has further said that it is not clear whether section 2(2) applies to other analogous transactions.[128] On another occasion, he has said, *"it [is] taken for granted that the owner of a part interest in goods could sell it to any person other than a co-owner"*.[129]

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120 Law Com No 215, at para 2.5.

121 Law Com No 215, at para 2.5.

122 [1954] CLY 2998.

123 (1835) 2 Bing NC 118.

124 Law Com No 215, at para 5.4.

125 Law Com No 215, at para 5.4. The Law Commission also said at para 2.6, *"The difficulty in saying that, say, a one-third share in a horse is unascertained goods is that there is no way in which property in the share could pass by sale while the horse is alive. This cannot have been intended. It would be absurd for the law to be, on the one hand, that there can be a sale of a part share in goods such as a horse, ship, painting or table which cannot be divided without being destroyed, but, on the other, that property in the part share could never pass without actual division of the goods. Section 16 draws no distinction between goods of this type and goods which could be easily divided. There is, on the other hand, no difficulty in saying that if a specified undivided share (such as a quarter) in goods is 'goods' then that share is identified and agreed on, as clearly as it ever can be while remaining an undivided share, if the goods in which it is a share are identified and agreed on."*

126 *"Thus a sole owner's transfer of only part of his interest so as to create a tenancy in common would not be a sale of goods. Similarly, a transfer by a co-owner of part of his interest would be outside the statutory definition . . ."* R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 205 n 64.

127 *"It is arguable that [section 2(2)] is wide enough to include the transfer by a tenant in common both of the whole of his interest and also of a portion only of his interest ...." Benjamin's Sale of Goods* 5th Ed 1997, at para 1-120.

128 These include *"the transfer by the owner of a part interest in goods of the whole of that interest to a third party, or the transfer by the owner of goods of one or more part interests in them so as to make the transferee or transferees and himself co-owners." Benjamin's Sale of Goods* 5th Ed 1997, at para 1-120.

129 *Benjamin's Sale of Goods* 5th Ed 1997, at para 1-80.

Professor Bridge has also mentioned that *"by common law analogy, the relevant provisions of the Sale of Goods Act could be applied to a contract concerning the sale of an undivided share"*.[130] It appears that the issue is unsettled.

9.71 As to the Law Commission's second argument, *Van Cutsem v Dunraven*[131] is only a first instance unreported case on the now repealed section 4 of the 1893 Act. It was reported in the Current Law Yearbook[132] without analysis of the reasons why an undivided share in goods was intended to be within the 1979 Act. Another case cited by the Law Commission was *Marson v Short*.[133] It was held that a sale by the owner of a horse of a half share in it was a sale of goods for the Stamp Act purposes. First, this case was about the Stamp Act. Secondly, once again, there was not much analysis of whether an "undivided share" was "goods" or a chose in action. There is a case stating that a part share in goods is a chose in action. In *Re Sugar Properties (Derisley Wood) Ltd*,[134] a part share in a horse was treated as a chose in action, but in the context of section 4 of the Bills of Sale Act 1878 in which the concept of transfer by delivery was central. Therefore, before the 1995 Act, it was not clear whether a part share in goods was "goods" or not. Professor Sealy said before the 1995 Act, *"[a] contract for the transfer of an undivided share in a specific chattel (or, semble, any goods) is a contract of sale of goods within the Act …. Whether it follows that a part-interest in goods is itself 'goods' is uncertain …"*[135]

9.72 In Hong Kong, the position concerning a sale of undivided shares, specified as a fraction, is as uncertain as it was in England before the 1995 Act. Section 3(1) of Cap 26, which is modelled on section 2(2) of the 1979 Act, also recognises that there may be a contract of sale between one part owner and another.[136] Similar to the position of England then, the effect of section 3(1) is not entirely clear. It is also uncertain whether a sale of an undivided share, specified as a fraction, in specific goods is regarded as a sale of goods, or more precisely, specific goods. It would be preferable to clarify this in Cap 26. Extending the definitions of "goods" and "specific goods" in Cap 26 in the same way as in the 1995 Act can be an option.

9.73 No cases can be found on the two extended definitions introduced by the 1995 Act. Some academics have mentioned the extended definitions in their books, including Professor Sealy,[137] Professor Michael Bridge[138] and Professor Treitel.[139] Professor Sealy has commented, *"[i]t is*

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130 M Bridge, *The Sale of Goods*, 1997, at p 31.

131 [1954] CLY 2998.

132 It is not available by way of Lexis-Nexis research either.

133 (1835) 2 Bing NC 118.

134 [1988] BCLC 146.

135 *Benjamin's Sale of Goods,* 4th Ed, 1992, at para 1-80. He also said at para 1-119, "*[w]hat is less clear is whether a part share or interest in goods is itself 'goods' for the purpose of the Act.*"

136 Section 3(1) of Cap 26 reads, " …There may be a contract of sale between one part owner and another."

137 *Benjamin's Sale of Goods,* 5th Ed, 1997, at paras 1-80, 1-115, 1-120.

138 M Bridge, *The Sale of Goods,* 1997, at p 30-31.

139 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 18-230.

thus made clear beyond doubt that the sale of an undivided share in goods … is governed by the Act."[140] On the other hand, Professor Treitel has expressed his view on the practical side, *"[i]t is possible for a seller who is fraudulent, careless or forgetful to sell a number of fractions which together amount to more than the whole: e.g. to sell one quarter of a cargo to each of five buyers."*[141]

9.74 Academics have found the extended definitions generally acceptable. However, we will discuss the following issues before drawing any conclusion.

9.75 First, the exact effect of section 3(1) of Cap 26 and whether a sale of an undivided share expressed in a fraction in goods is governed by Cap 26 are still far from clear. The extended definitions in the 1995 Act would put this beyond doubt. The question is whether it is necessary, at least at this stage, to justify conceptually why "an undivided share" of goods is goods (chattel), but not a chose in action. In replying to this question, Professor Reynolds has said, *"I do not myself see much problem in calling such interests goods whatever the position before the Act (which was indeed uncertain)."*[142]

9.76 Secondly, there is the implication of extending the two definitions. The Law Commission has pointed out that since an undivided share in goods cannot be physically possessed or delivered, the provisions on possession and delivery in the 1979 Act will simply disapply themselves.[143] This arises most obviously where the goods cannot be divided up, as in respect of a share in a boat or a horse.[144] The intention of the parties will then prevail.

9.77 This is also true for the other provisions of the 1979 Act which are based on possession or delivery. For example, section 18 of the 1979 Act (equivalent to section 20 of Cap 26) provides rules for ascertaining the intention of the parties as to the time at which the property is to pass. All these rules refer to the goods being in a deliverable state or being delivered, and would therefore not apply to an undivided share which is never in a deliverable state and cannot be delivered. As a consequence, the intention of the parties will prevail in respect of matters concerning possession or delivery. Sections 27 to 37 of the 1979 Act (equivalent to sections 29 to 39 of Cap 26) provide another example. These provisions are also based on delivery and accordingly are inapplicable to a sale of an undivided share. Again, this would mean that the obligations of the parties depend on the contract itself.

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140 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 1-80.

141 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 18-230. He continues, *"[section 20A(4) of the 1995 Act provides] for this type of situation where specified but undifferentiated quantities are sold out of a single shipment: eg where five lots of 200 tons each are sold to different buyers out of a cargo of only 80 tons. But these provisions do not apply where the quantities sold are expressed as fractions; and there seems to be no common law authority on how the cargo is to be allocated in such a case."*

142 In an e-mail to the Secretary dated 28 February 2000.

143 Law Com No 215, at paras 5.5-5.7.

144 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 1-115.

The Law Commission is of the view that this is "*not so obviously unsatisfactory that any special rule is required*."[145]

9.78 Another practical consequence is how will the statutory implied terms in sections 14 to 17 (one of the major benefits to buyers of falling within Cap 26) apply to undivided shares? There should be no problem in applying these terms once the goods, which are the subject matter of the undivided shares are physically separated.[146] But how will these terms apply if the shares remain undivided?[147] It seems that the implied terms as to a right to sell and freedom from encumbrance would apply to a sale of an undivided share. But other implied terms, such as quiet possession, correspondence with description, etc would probably disapply themselves.

9.79 Most provisions in Cap 26 will therefore not apply to a sale of an undivided share, including most of the statutory implied terms which protect buyers. In respect of many aspects, the intention of the parties will prevail. Moreover, the implication of extending the two definitions is not free of doubt. Professor Sealy has said that the Law Commission has not considered the implication other than the passing of property, delivery and acceptance, and whether the change will be of any practical consequences remains to be seen.[148]

9.80 The Law Commission has emphasised that extending the two definitions is only a minor amendment to remove some elements of doubt.[149] We are not aware of any particular hardship relating to this issue, especially in ordinary consumer transactions. We therefore do not see any urgency for extending the two definitions.

9.81 We therefore conclude that the two definitions should not be extended until the implication of the extension in England becomes clearer.

Rights of partial rejection

9.82 Section 13(3) of Cap 26 provides as follows:

> *"Where a contract of sale is not severable, and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, and not as a ground for rejecting the goods and*

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145 Law Com No 215, 1993, at paras 5.6-7.

146 *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 1-115. *"Where the goods are bulk goods which are capable of physical separation, and it is contemplated by the contract that they will be divided up and the portion due to the buyer will be physically delivered, some parts of the Act will be applicable to such delivery."*

147 Professor Sealy has said, *"[p]lainly, certain provisions are not capable of literal application to transactions involving a part interest- for instance, the implied warranty as to quiet possession ..." Benjamin's Sale of Goods*, 5th Ed, 1997, at para 1-80.

148 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 1-115.

149 Law Com No 215, 1993, at para 5.1.

treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect."

9.83 Under section 13(3), where a contract of sale is not severable, a buyer who has accepted some of the contract goods will be treated as having accepted all the contract goods. The effect is that he will lose his right of rejection. Therefore, the options he has are either to accept all the goods or to reject all of them, even though he still has the right to claim damages in either case. He cannot reject the non-conforming goods and keep the conforming ones. In other words, once he has accepted any goods, he cannot reject any of the contract goods even though some of them may not conform to the contract. For example, if a buyer has 100 kg of grain delivered to him, 30 kg of which do not conform to the contract, the buyer would then have to decide whether to accept or reject the whole 100 kg.

9.84 Section 32(3) of Cap 26 provides for an exception to this general rule. Where the goods delivered to a buyer consist of goods of a different description to those included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest, or he may reject the whole. Section 32(3) reads as follows:

"Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract the buyer may accept the goods which are in accordance with the contract and reject the rest, or he may reject the whole."

9.85 The problem of the existing law is that it forces buyers to choose either to accept or reject all the contract goods when only some of them do not conform to the contract. For various reasons, the general rule in section 13(3) is too stringent and the exception in section 32(3) is too narrow. First, it is reasonable and sensible to allow buyers to be able to reject only the non-conforming goods and accept the rest. In the example given above, it will make more commercial sense, from both the buyer's and seller's points of view, if the buyer can reject the 30 kg non-conforming grain and accept the remaining 70 kg, instead of either accepting or rejecting the whole. Secondly, the all-or-nothing approach in section 13(3) not only deprives buyers of choices, but also may not necessarily be in the sellers' interests. For example, if a buyer is forced to reject all the contract goods, the seller will then have to refund more of the contract price. Thirdly, the exception in section 32(3) only applies to the delivery of goods of a different description not included in the contract. It is questionable why the exception only applies to delivery of goods of a different description, but not to other breaches, such as, breaches in respect of quality, fitness for purpose, correspondence with sample, etc. The Law Commission of England and Wales has stated:

"the difference between description and quality is often so slight that it is not easy to justify a different result depending on

whether the breach of contract related to description or to quality."[150]

Experience in other jurisdictions

9.86 In the following paragraphs, we will discuss the position in other jurisdictions first before making recommendations. Section 2-601 of the Uniform Commercial Code of the United States provides:

> *"Subject to the provisions of this Article on breach in installment contracts (Section 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may*
> *(a) reject the whole; or*
> *(b) accept the whole; or*
> *(c) accept any commercial unit or units and reject the rest."*[151]

9.87 Under section 2-601, a buyer's right of partial rejection is relatively wide. He can reject the non-conforming goods and retain the rest. Indeed, he can reject all or any of the non-conforming goods, as well as all or any of the conforming goods. The only limitations on his right of partial rejection are the requirements as to good faith and commercial reasonableness. Therefore, buyers cannot reject goods forming part of a commercial unit to avoid undue impairment of the value of the remaining portion of the goods. The Official Comment[152] on section 2-601 summarises its effect:

> *"A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the 'commercial unit' in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so*

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150 The Law Commission stated this when recommending a general right of partial rejection. *Sale and Supply of Goods*, Law Com No 160, 1987, at para 6.8.

151 The HTML version of the Uniform Commercial Code published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws; reproduced, published and distributed with the permission of the Permanent Editorial Board for the Uniform Commercial Code. <http://www.law.cornell.edu/ucc/ucc.table.html> (29 Feb 2000)

152 "*Each section of the UCC is the subject of an 'Official Comment'. While these comments have not been enacted by state legislatures, they are heavily relied on by lawyers and courts. They are, by far, the most important source of assistance in interpreting the Code*." <http://www.law.cornell.edu/ucc/context.html> (29 Feb 2000)

materially adverse an effect on the remainder as to constitute bad faith."

9.88 Under section 2-105,

"'commercial unit' means:

such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole."

9.89 In England and Wales, the position was originally similar to that in Hong Kong. The Sale and Supply of Goods Act 1994 prompted by the Law Commission's report[153] provides for buyers to have a general right of partial rejection by adding a new section 35A to the 1979 Act. Section 35A provides as follows:

"(1) If the buyer –

(a) has the right to reject the goods by reason of a breach on the part of the seller that affect some or all of them, but

(b) accepts some of the goods, including, where there are any goods unaffected by the breach, all such goods,

he does not by accepting them lose his right to reject the rest.

(2) In the case of a buyer having the right to reject an instalment of goods, subsection (1) above applies as if references to the goods were references to the goods comprised in the instalment.

(3) For the purposes of subsection (1) above, goods are affected by a breach if by reason of the breach they are not in conformity with the contract.

(4) This section applies unless a contrary intention appears in, or is to be implied from, the contract."

9.90 The right of partial rejection under section 35A is general in the sense that it covers all types of non-conformity, not just goods of different

[153] *Sale and Supply of Goods*, Law Com No 160, 1987.

description. As before, a buyer can choose to reject or accept all the contract goods. Alternatively, he can accept the conforming goods, and can choose either to reject all or any of the non-conforming goods. He will only have a right to reject part of the contract goods if he has a right to reject the whole. If he chooses to accept any conforming goods, he must retain all, and not just some of them.

Conclusion

9.91 The Law Commission considered the Uniform Commercial Code in its report before making their recommendations. There are some similarities between the American and English provisions. In the following paragraphs, we will discuss the similarities first, and then the differences between the two jurisdictions. We will make recommendations while discussing the similarities and differences. First, in both jurisdictions, buyers have a general right of partial rejection, whether or not the contract is severable, covering all types of non-conformity, not just goods of different description. Professor Michael Bridge has mentioned:

> *"Partial acceptance will often make good commercial sense and can be seen at work already in the cases where the parties have voluntarily agreed upon it. It can often be the solution that minimizes the losses caused by the tender of non-conforming goods."*[154]

9.92 Secondly, the English provisions have adopted the American concept and definition of "commercial unit" in the Uniform Commercial Code to limit a buyer's right of partial rejection. This limitation is sensible so as not to impair the value and character of the goods which have to be used as part of a unit, such as, a pair of shoes or a pair of gloves. In such cases, buyers should not be entitled to reject non-conforming goods forming part of a commercial unit and retain the conforming ones. Professor Atiyah has said:

> *"There seemed to be no sound reason of commercial policy for refusing to allow the buyer to accept part and reject part of the goods delivered, whether or not the contract is severable in the technical sense, provided only that the goods constituted different 'commercial units'. …Whilst the above discussion [on sections 11(4) and 30(4)] will still be relevant for some time to come in relation to contracts entered into before the commencement of the 1994 Act, thereafter the situation will be*

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154 M Bridge, *The Sale of Goods*, 1997, at p 168. Brian Childs has doubted whether the new statutory rights of partial rejection would make much difference since under the previously existed law, the parties were free to contract out the "all or nothing" approach in section 11(4) (equivalent to section 13(3) of Cap 26). But he has emphasised that the symbolic significance of the reversal should not be underestimated. The signal is that the law favours partial rejection and the burden is on those who want to retain the "all or nothing" approach to keep it. See Brian Childs, "Goodbye to all that?", (1995) 46 NILQ 232, at p 240. Professor Bridge has also made similar remarks. See M Bridge, "Commercial Sales - The Sale and Supply of Goods Act 1994" [1995] JBL 398, at p 407.

much improved. …All this will simplify the law in a number of respects. In general it means that the question of acceptance will only arise with respect to the very goods accepted, other goods under the same contract not being affected - except in the one, rather obvious, case where the goods are all part of one commercial unit. Obviously, if a buyer buys one commercial unit, he cannot accept part and reject part."[155]

9.93 We are of the view that giving buyers rights of partial rejection should alleviate the problems brought about by the stringent rule in section 13(3) and the narrow exception in section 32(3) of Cap 26. We accordingly recommend that buyers should have a general right of partial rejection, whether or not the contract is severable, covering all types of non-conformity subject to an exception in respect of goods forming part of a "commercial unit".

9.94 Thirdly, in both jurisdictions, buyers can reject all or some of the non-conforming goods. This provision makes some practical and commercial sense. There is no point in compelling a buyer to reject all the non-conforming goods if he chooses to accept some of them. The extent of non-conformity can vary from one item to another, and this means that a buyer can probably find some use for some of the non-conforming goods. If he chooses to do so, as pointed out by the Law Commission,[156] he should be encouraged to do so, and should not be compelled to reject goods which he wishes to accept despite the non-conformity. We therefore recommend that in exercising his right of partial rejection, a buyer should be able to reject all or some of the non-conforming goods.

9.95 Fourthly, both the American and English provisions provide that the right of partial rejection is subject to contrary intention. Given the weaker bargaining power of consumers and the common use of standard term contracts unilaterally imposed by sellers, the right of partial rejection can easily be contracted out. It may be possible to argue that Cap 71 controls the exclusion of a consumer's right of partial rejection.[157] Under section 8(2)(a)[158] of Cap 71, a seller cannot, as against a consumer, or where the contract is on the seller's written standard terms of business, by reference to any contract term, exclude or restrict any liability except if that contract term is reasonable.

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155 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 475-476.

156 Law Com No 160, 1987, at para 6.11.

157 Professor Paul Dobson has also said: *"although section 35A(4) states that this section applies only if a contrary intention does not appear, nevertheless, a clause in a contract which purported to deprive the buyer of his right of partial rejection would be an exclusion clause and therefore could well be rendered ineffective by the Unfair Contract Terms Act 1977."* Dobson, *Sale of Goods and Consumer Credit*, 5th Ed, 1996, at para 13-04.

158 Section 8 is equivalent to section 3 of the 1977 Act and reads as follows:
"(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.
(2) As against that party, the other cannot by reference to any contract term -
(a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or …
except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness."

Section 5(1)(b)[159] extends this to cover exclusion or restriction of any right or remedy in respect of liability.

9.96 We are however of the view that there is doubt as to whether section 5(1)(b) of Cap 71 covers a "right" especially, which is expressly made subject to contrary intention. Moreover, even if Cap 71 is applicable, an ordinary consumer may have great difficulty in ascertaining whether or not the contracting out provision satisfies the "reasonableness" test before deciding whether to exercise his right of partial rejection. For the sake of certainty and better protection to consumers, we recommend that the legislation should spell out expressly that in the case of consumers, the parties cannot contract out the right of partial rejection. One of our Sub-committee members has expressed the view that in the case of non-consumers who deal on sellers' standard term contracts, any contracting out provision on the right of partial rejection should only be valid if it satisfies the "reasonableness" test. This would be in line with the spirit of Cap 71 as enshrined in section 8(1). The majority view is that non-consumers are usually in a better position than consumers to bargain with sellers, and the right to reject all the goods should already give them adequate protection. However, we seek views, comments and suggestions on this issue generally, especially from suppliers and commercial buyers.

9.97 On comparison, there are also a number of differences between the American and English provisions. The English provisions provide for some matters expressly, for which the American provisions do not. First, the English provisions have made it express that a buyer must have the right to reject the whole before he can have a right of partial rejection. There is particular value in making this express in view of the recommendation in Chapter 7 concerning restriction on non-consumers' rights to rejection. If a non-consumer buyer loses his right of rejection in general, he will not have the right of partial rejection. Secondly, the English provisions also make it express that the right of partial rejection is subject to a contrary intention made in or implied from the contract. This will also be welcomed as it gives the parties freedom to decide for themselves whether or not to include such a right of partial rejection in their contract. As discussed, this should not apply to consumers. We therefore recommend that a buyer must be entitled to reject the whole before he can have a right of partial rejection, and in case of non-consumers, such a right should be subject to a contrary intention made in or implied from the contract.

9.98 Thirdly, under the English provisions, if a buyer chooses to accept any conforming goods, he must accept all, and not just some of them, while under the American provisions he may choose to accept only some of the conforming goods. One member of our Sub-committee prefers the

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[159] Section 5 is equivalent to section 13 of the 1977 Act and reads as follows:
"(1) To the extent that this Ordinance prevents the exclusion or restriction of any liability it also prevent -
..;
(b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy ..."

American approach and observes that the buyer has contracted for a specific quantity of goods. If that quantity cannot be supplied in its entirety, it may be that the buyer may wish to adjust his needs and may then require only a quantity smaller than that of the conforming goods.

9.99 After extensive deliberation, the majority prefer the English provisions. As a matter of principle, buyers should not be given the choice as to the quantity of the conforming goods which they wish to accept, since these already conform to the contract. To do otherwise would amount to rewriting the contract and would be unfair to sellers, especially when buyers reject some of the conforming goods because of extrinsic reasons, such as changes in the market. We believe that the right to reject all the goods should provide adequate protection to buyers. We therefore favour the English approach.

9.100 Fourthly, the definition of "commercial unit" in the English 1979 Act is based on that in its American counterpart, but the English provision omits the reference to "*a unit of goods as by commercial usage is a single whole for purposes of sale*". The Law Commission has recommended adopting the concept of "commercial unit" used in the United States Uniform Commercial Code.[160] After pointing out that the 1979 Act has not adopted the definition in the Uniform Commercial Code in full, Nicholas Hamblen has observed that "*trade practice and usage is likely to be an important factor in determining what is or is not to be regarded as a 'commercial unit*'."[161] We are of view that commercial usage should be useful in deciding what is a "commercial unit". The Law Commission has also referred to it when explaining the concept of "commercial unit" with examples.[162] We therefore recommend that the definition of "commercial unit" in section 2-105 be adopted.

9.101 Fifthly, the English provisions expressly state that where the sale is by instalments, the right of partial rejection will apply to each instalment. Professor Bridge has pointed out that the *"existence of severable rejection rights is implicit in section 35A(2) which permits the buyer to accept only a part of a non-conforming instalment and reject the rest."*[163] We find it helpful for the avoidance of doubt to make it clear that the rights of partial rejection apply to each instalment and we so recommend.

9.102 With the enactment of the recommended general right of partial rejection, the limited right of partial rejection in section 32(3) of Cap 26 just covering goods of different description would become redundant and should be repealed consequentially. We recommend repealing section 32(3).

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160 *Sale and Supply of Goods*, Law Com No 160, 1987, at paras 6.12-6.13. *The Halsbury's Statutes* has mentioned that the definition of "commercial unit" in the 1979 Act is *"based on that used in the United States Uniform Commercial Code"*. *Halsbury's Statutes*, 4th Ed, 1995, Vol 39 at p 104 notes.

161 Nicholas Hamblen, "The Sale and Supply of Goods Act 1994 Reviewed" (1996) 1(4) CL 7.

162 "*The buyer would not be restricted [by the concept of 'commercial unit'] if it was merely the seller (and not the trade in general) who chose to sell goods in that particular way*." Law Com No 160, 1987, at para 6.13(ii).

163 M Bridge, *The Sale of Goods*, 1997, at p 185. See also Law Com No 160, 1987, at para 6.15.

Recommendation 25

We recommend repealing section 32(3) of Cap 26, and that provisions on a right of partial rejection similar to those in section 35A of the English Sale of Goods Act 1979 should be made in Cap 26, namely:

(a) subject to (b) below, where a buyer has a right to reject because of a breach by the seller which affects some or all the goods, and has accepted some of the goods including all the goods unaffected by the breach, he can still reject the rest of the goods, and in the case of consumers, the application of this paragraph cannot be excluded or restricted by reference to any contract terms; and in case of non-consumers, such a right should be subject to a contrary intention made in or implied from the contract;

(b) a buyer accepting any goods in a commercial unit is deemed to have accepted all the goods making the unit; and "commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use;

(c) where a buyer has a right to reject an instalment of goods, the principles in (a), (b) and (d) also apply as if references to the goods were references to the goods comprised in the instalment;

(d) goods are affected by a breach if they do not conform to the contract.

Statutory exception to the *nemo dat* rule : sale in market overt

9.103 Section 24 of Cap 26[164] provides for an exception to the basic principle of sales law expressed in the Latin maxim *nemo dat quod non habet* rule,[165] and reads as follows:

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164 "*The nemo dat rule, which is heavily relied on by sellers to secure payment of the price by reserving title until payment, is enshrined in* [section 23(1) of Cap 26] …": R M Goode, *Commercial Law*, 2nd Ed, 1995, at p 451-452.

165 One cannot give what he does not have: a seller cannot give the buyer any better title than he himself has.

"Where goods are openly sold in a shop or market in Hong Kong, in the ordinary course of the business of such shop or market, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of any defect or want of title on the part of the seller."

9.104 Cap 26 has not defined the term "shop" and it is a question of fact for each case to determine what is a shop. According to *Au Muk Shun v Choi Chuen Yau,*[166] there are four conditions to fulfill before the section applies, namely:

(a) the goods must be openly sold;

(b) the sale must take place in a shop or market;

(c) the purchaser must act in good faith and without any notice of any defect of title; and

(d) the sale must be in the ordinary course of business of that shop or market.

9.105 The section is modelled on the repealed[167] section 22 of the 1979 Act of England and Wales which reflected the common law position before its enactment. Professor Goode has given a clear account of the historical background of the market overt rule:

"The market overt rule, which now appears to be peculiar to English law, originated in the days when shops were few, most goods were bought and sold at markets and fairs, and private sales were severely discouraged as being likely to involve stolen goods. One who received stolen goods and was not able to show that he had acquired them in open market stood in considerable danger of being hanged. The owner, for his part, was expected to look for his goods in the market; and if he did not intervene at the market prior to the sale of the goods, the bona fide buyer was given an assurance of good title."[168]

9.106 Section 22 of the 1979 Act only applied to a sale in a market overt as defined in court cases. The sale had to be made in an *"open public and legally constituted market"*.[169] To be legally constituted, where a market was outside the City of London, it had to be established by grant, prescription or statute.[170] If a market was within the City, by custom of the city it was legally constituted if it was on the ground floor and open to the street and the

166 [1988] 1 HKLR 413.

167 The Sale of Goods (Amendment) Act 1994 (1994 c 32) repealed section 22 of the 1979 Act.

168 R M Goode, *Commercial Law*, 1st Ed, 1982, at p 401.

169 *Lee v Bayes* (1856) 18 CB 599, per Jervis, CJ at p 601, cited with approval in *Bishopsgate Motor Finance Corp Ltd v Transport Brakes Ltd* [1949] 1 KB 322.

170 *Bishopsgate Motor Finance Corp Ltd v Transport Brakes Ltd* [1949] 1 KB 322.

goods were openly displayed.[171] In addition, the entire sale had to take place in the market between the hours of sunrise and sunset.[172]

9.107 On contrast, section 24 of Cap 26 covers all shops and markets selling in the ordinary course of their business. Section 24 is therefore wider in scope.

9.108 We take this opportunity to examine whether Hong Kong should retain this age-old rule in our statute book. We first discuss the provisions in other jurisdictions and then the opinions of academics.

Experience in other jurisdictions

9.109 In Australia, the principal legislation regulating sale of goods transaction is the uniform legislation in force in each State and Territory: the Sale of Goods Act,[173] which is modelled on the English Sale of Goods Act 1893. For the purpose of discussion, we will focus on the Sale of Goods Act 1923 of New South Wales (the "1923 Act").

9.110 Although the 1923 Act, like other Sale of Goods Acts in other States and Territories, is modelled on the English 1893 Act, there is no provision equivalent to section 22 of the English 1979 Act. On the contrary, section 4(2) of the 1923 Act makes it express that the common law market overt rule does not apply in New South Wales. Section 4(2) provides as follows:

> *"The rules of the common law, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, and in particular the rules relating to the law of principal and agent, and the effect of fraud, misrepresentation, duress, or coercion, mistake, or other invalidating cause, shall continue to apply to contracts for the sale of goods, provided that there shall not be deemed to be or to have been any market overt in New South Wales."*

9.111 In Canada, provincial law basically regulates the law relating to sale of goods. Each common law province has its own Sale of Goods Act[174] which is also modelled on the English Sale of Goods Act 1893. We will single out the Sale of Goods Act 1990 of Ontario for discussion purposes. Similar to

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171 *Hargreave v Spink* [1892] 1 QB 25.

172 *Reid v Metropolitan Police Commissioner* [1973] QB 551.

173 (NSW) Sale of Goods Act 1923; (QLD) Sale of Goods Act 1896; (SA) Sale of Goods Act 1895; (TAS) Sale of Goods Act 1896; (VIC) Goods Act 1958; (WA) Sale of Goods Act 1895; (ACT) Sale of Goods Act 1954; (NT) Sale of Goods Act.

174 (ALTA) Sale of Goods Act 1980, c S-2; (BC) Sale of Goods Act 1996, C410; (MAN) Sale of Goods Act 1987, c S10; (NB) Sale of Goods Act 1973, c S-1; (NFLD) Sale of Goods Act 1990, c S-6; (NWT) Sale of Goods Act 1988, c S-2; (NS) Sale of Goods Act 1989, c 408; (ONT) Sale of Goods Act 1990, c S1; (PEI) Sale of Goods Act 1988, c S-1; (SASK) Sale of Goods Act 1978, c S-1; (Y) Sale of Goods Act 1986, c 154. See Gerald Fridman, *Sale of Goods in Canada*, 4th Ed, 1995, at p 3 and < http://www.qp.gov.bc.ca/bcstats/96410_01.htm> (4 July 2000).

Australia, the 1990 Act provides expressly that the *"law relating to market overt does not apply to a sale of goods that takes place in Ontario"*.[175]

9.112 In England, section 22, on which section 24 of Cap 26 was modelled, was repealed by the Sale of Goods (Amendment) Act 1994. Furthermore, the Sale of Goods Act 1908 of New Zealand, modelled on the English Sale of Goods Act 1893, also spells out that the *"law relating to market overt shall not apply in New Zealand."*[176]

Conclusion

9.113 All major jurisdictions in the common law world have either abolished or rejected at the outset the market overt rule. Not surprisingly, academics have criticised this rule. Professor Atiyah has pointed out, *"[t]his exception could be explained, but scarcely justified, on historical grounds only, and it may be regretted that it was included in the 1893 codification."*[177] Professor Goode has put it even more strongly, *"[t]he market overt rule has little to commend it, and should be abolished at the earliest opportunity."*[178]

9.114 The theory underlying the market overt rule is that an owner is expected to be able to find his lost goods in the market place. We are of the view that while the market overt rule may have worked well in the Middle Ages, it is inappropriate to modern conditions. This is even more so for section 24, which is wider than its English equivalent, since it applies to sale in "a shop or market in Hong Kong" and not just "market overt" as restrictively defined in court cases. It is unrealistic to expect an owner to be able to find his lost goods by searching the shops and markets of Hong Kong. As early as 1956, Professor E Ivamy said:

> *"It may be said that a sale in market overt in the country where goods are exposed for sale on stalls gives the real owner some opportunity of being able to track down his property before it is sold. But can the same be said of a sale in a retail shop? …In the old days it might have been possible for an owner to trace his property, for he would be able to go to those shops which specialised in the sale of goods similar to his own, but this is now less likely in the era of departmental stores which deal in great varieties of goods."*[179]

9.115 Professor Geraint Howells also echoes this view and has said:

> *" …in former times, when goods were not so easily transported, a person who had goods stolen from him could be expected to search the markets for them and if he failed to discover them it*

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175 Section 23.
176 Section 24.
177 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 341.
178 R M Goode, *Commercial Law*, 1st Ed, 1982, at p 401.
179 E R H Ivamy, "Revision of the Sale of Goods Act" [1956] CLP 113, at p 129-130.

would be unfair to allow him to reclaim them from an innocent purchaser, who bought them at a public market. This was perhaps never very fair, but of course is less so nowadays when thieves can easily dispose of goods at the other end of the country. This, combined with the fears of a thief's paradise created by the explosion of car boot sales, explains why abolishing the rule was seen as desirable."[180]

9.116 We accordingly recommend abolishing the market overt rule in section 24 of Cap 26. The remaining question is whether a new rule should be provided to replace it as Professor Howells has said, *"abolition of the market overt rule by itself is only a partial solution to the problems which are encountered in this area of the law".*[181] The Law Reform Committee of England and Wales proposed replacing the market overt rule with another rule: passing good title to innocent retail buyers purchasing in good faith at trade premises or public auctions.[182] This recommendation contained in the report issued in 1966 has yet to be implemented. Professor Diamond[183] has proposed replacing the market overt rule with a new principle that where an owner has entrusted the goods to, or acquiesced in their possession by, another person, a disposition by that person would pass good title to innocent purchasers. Furthermore, the Department of Trade and Industry of England in 1994 issued a consultation paper[184] proposing reform along the lines advocated by Professor Diamond. As the consultation has shown no consensus,[185] this proposal has not been implemented. On responding to the question as to why all these proposals have not been implemented, Professor Hugh Beale has said:

"I am not aware of the reasons for non-implementation of these proposals in any detail. The Law Reform Committee's paper was felt to be inadequate, and even more so the DTI's. Another reason for rejection of the LRC's proposal was, I believe, the fear that it would make it easier to fence stolen goods. I think the main reason for Diamond's and the DTI's being ignored is that they were seen as connected to the question of security over personal property (the main focus of the Diamond report) and there was industry opposition to making changes on the scale Diamond wanted – things were felt to work well enough. As you know, all we have done is to go in the opposite direction by abolishing market overt (the direct result of Lincoln's Inn discovering two paintings stolen from the Inn had been sold in a market in London and could not be recovered from the buyers!)"[186]

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180 G Howells, *Consumer Contract Legislation-Understanding the New Law*, 1995 at p 31.

181 G Howells, *Consumer Contract Legislation-Understanding the New Law*, 1995 at p 32.

182 "Transfer of Title to Chattels", Report of the Law Reform Committee, Twelfth Report (1966) Cmnd 2958.

183 "A Review of Security Interests in Property", 1989.

184 "Transfer of Title: Sections 21 to 26 of the Sale of Goods Act 1979", 1994.

185 This is according to an e-mail to the Secretary of the Sub-committee dated 29 March 2000 from Martyn Rapley, Consumer Affairs Directorate, Department of Trade and Industry.

186 In an e-mail to the Secretary dated 24 April 2000.

9.117 One member of our Sub-committee has mentioned that the obsolescence of the market overt rule does not negate the need to protect innocent buyers of stolen goods, and section 24 should not be repealed unless there is a replacement. After extensive deliberations, we recommend abolishing the market overt rule with no replacement for the following reasons. First, the rationale of the proposed replacement rules is to protect innocent purchasers. However, we have to strike a balance between protecting innocent purchasers and innocent owners. As Professor Howells has observed:

> *"The motivation for [abolishing the market overt rule] was the belief that the [rule] allowed markets to be used as a place for stolen goods to be sold in a way which defeated the claim of the true owners."*[187]

9.118 We believe that as between an innocent buyer and an equally innocent owner, an owner is more vulnerable. A buyer can protect himself by inquiring as to the source of the goods, going to more reputable shops, etc. It could be argued that an owner can also protect himself by taking precautions against burglary and robbery, but sometimes burglary and robbery cannot be prevented no matter how cautious an owner is. An owner is in a more passive position than a buyer, who can take a more active role to protect himself. Moreover, if the goods have special meaning for an owner, loss of the goods may involve sentimental elements, quite apart from any pecuniary loss.

9.119 Secondly, there are already a number of exceptions to the *nemo dat* rule in sections 23 to 27 of Cap 26 to protect deserving innocent purchasers. A Sub-committee member is of the view that these sections do not specifically protect innocent buyers of stolen goods, and repealing section 24 without replacement will leave a vacuum in this area. The majority of our Sub-committee find that owners are in a less favourable position. The Pawnbrokers Ordinance (Cap 166) has provided some protection against the disposal of stolen goods,[188] but Cap 166 applies only in the context of pawning goods, and not to other disposal of stolen goods in markets or shops. The protection provided by Cap 166 is therefore limited. Thirdly, all major common law jurisdictions have either abolished or rejected the market overt rule without replacing it.

Recommendation 26

We recommend repealing section 24 of Cap 26.

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187 G Howells, *Consumer Contract Legislation-Understanding the New Law*, 1995 at p 29.

188 For example, sections 12 and 18 require a pawnbroker to record the details of every loan, and a borrower to provide some prescribed information to the pawnbroker respectively. Section 19 makes it an offence for any person who pawns goods owned by another without being duly authorised or employed by the owner in that behalf.

Remedies for delivery of wrong quantity

9.120 Section 32 of Cap 26 provides for buyers' remedies for delivery of wrong quantity and reads as follows:

> *"(1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered, he must pay for them at the contract rate.*
>
> *(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest, or he may reject the whole. If the buyer accepts the whole of the goods so delivered he must pay for them at the contract rate.*
>
> *(3) Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract the buyer may accept the goods which are in accordance with the contract and reject the rest, or he may reject the whole.*
>
> *(4) The provisions of this section are subject to any usage of trade, special agreement, or course of dealing between the parties."*

9.121 Under section 32(1), where a seller delivers less than the contract quantity to a buyer, the buyer may reject the goods. Similarly, under section 32(2), a buyer may also reject the whole of the goods if what are delivered are more than the contract quantity. This right of rejection is, however, subject to some restrictions, expressed in the Latin phrase: *de minimis non curat lex* (the law pays no attention to trifles). Where a long or short delivery is "microscopic"[189] and is not capable of influencing a buyer's mind,[190] he cannot reject the goods. The court will decline the right of rejection if the difference in quantity is merely trivial, such as an excess of 55 lbs of wheat over the contract quantity of 4,950 tons.[191]

9.122 In Chapter 7, we recommend restricting non-consumers' rights of rejection on sellers' slight breaches of the statutory implied terms (sections 14-17) for contracts of sale of goods. The question is whether there should be such restrictions on buyers' rights of rejection on delivery of a wrong quantity.

9.123 In England, with the introduction of section 15A into the 1979 Act on restricting non-consumers' right to reject on sellers' slight breaches of the statutory implied terms (sections 12-15), new section 30(2A) and (2B) of

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189 *Acros Ltd v E A Ronaasen & Son* [1933] AC 470, at p 480.

190 *Shipton Anderson & Co v Weil Brothers & Co* [1912] 1 KB 574, at p 577.

191 *Shipton Anderson & Co v Weil Brothers & Co* [1912] 1 KB 574.

the 1979 Act was also enacted to restrict non-consumers' rights of rejection on delivery of a wrong quantity. The relevant extracts of section 30, on which section 32 of Cap 26 is modelled, provide as follows:

> *"(1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he must pay for them at the contract rate.*
>
> *(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest, or he may reject the whole.*
>
> *(2A) A buyer who does not deal as consumer may not –*
>
> *(a) where the seller delivers a quantity of goods less than he contracted to sell, reject the goods under subsection (1) above, or*
>
> *(b) where the seller delivers a quantity of goods larger than he contracted to sell, reject the whole under subsection (2) above,*
>
> *if the shortfall or, as the case may be, excess is so slight that it would be unreasonable for him to do so.*
>
> *(2B) It is for the seller to show that a shortfall or excess fell within subsection (2A) above."*

9.124 Professor Michael Bridge is of the view that the new section 30(2A) and (2B) does not add much to the *de minimis* maxim. He has said:

> *"It is uncertain what the new section 30(2A) adds to the de minimis maxim; it prevents the rejection of a short tender by a non-consumer buyer where the shortfall is slight and rejection would be unreasonable. It must add something since, unlike the de minimis maxim, it does not apply to consumer buyers, but it is unlikely to add very much. …Further, section 30 (2A) prevents a non-consumer buyer from rejecting the goods where the surplus where it is slight and rejection would be unreasonable. As in the case of short delivery, it is unclear what this provision adds to the de minimis* maxim.*"*[192]

9.125 On the other hand, some academics are in favour of the new restriction. Indeed, there are various reasons to impose such a restriction. First, academics are generally of the view that the *de minimis* maxim only applies to "microscopic" difference. Professor Bridge has said: *"the courts will*

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[192] M Bridge, *The Sale of Goods*, 1997, at p 227-228.

tolerate microscopic (but not minor) deviations from contractual amount falling within the maxim de minimis non curat lex …"[193] It seems that the new section 30(2A) and (2B) should cover cases not within the *de minimis* maxim. For example, a short delivery of slightly less than 1% of timber complying with the contract requirement[194] was held not to be within the maxim, but it may be caught by the new section. Professor A G Guest has expressed the following opinion:

> *"Subsection (2A) is not merely a re-statement in statutory terms of the de minimis rule, despite the reference to the shortfall or excess being 'slight'. A shortfall or excess which is more than de minimis can therefore fall within its scope. It would no doubt be unreasonable for a buyer to reject the goods delivered on the ground of a slight shortfall in the contract quantity if it was not essential to him to receive the whole of that quantity and if he could be adequately compensated in damages for non-delivery of the undelivered balance. With respect to an excessive delivery, it would be unreasonable for a buyer to reject the whole of the goods delivered on the ground of a slight excess over the contract quantity if, for example, it was commercially practical for him to separate out the correct quantity and reject the excess or if he was not required by the seller to pay for the excess."*[195]

9.126 Secondly, a buyer's right to reject under section 32 of Cap 26[196] is parallel to his rights to reject under the statutory implied terms (sections 14-17). If a non-consumer's rights to reject under these statutory implied terms are restricted, his right to reject under section 32 should also be subject to the same restriction. Professor Atiyah has pointed out:

> *"This amendment brings the right of rejection for breach of the quantity provisions of the Act into line with the new provisions regarding the right to reject for breach of the implied terms as to quality and fitness … The fact that the buyer may be entitled to reject the whole of the goods delivered in the circumstances dealt with by s30 means that in substance the seller in such cases is treated as though he commits a breach of condition by delivering the wrong quantity. …it is undesirable for the law to distinguish between breaches of ss13-15 and breaches of s30, and in general the law does not do so. So it seems clearly right that the limitation on the right to reject in non-consumer sales introduced by the 1994 Act should apply equally to breaches of the implied terms as quality and to breaches of s30."*[197]

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193 M Bridge, *The Sale of Goods*, 1997, at p 227.

194 *Wilensko Slaski Towarzystwo Drewno v Fenwick & Co Ltd* [1938] 3 All ER 429.

195 *Benjamin's Sale of Goods*, 5th Ed, 1997, at para 8-047.

196 Section 30 of the 1979 Act in England.

197 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 108-110.

9.127 Thirdly, applying the *de minimis* maxim means that there is no breach at all and a buyer will be left with no remedies. Professor Atiyah has said, *"the effect of applying [de minimis maxim] is that there is no breach of warranty at all."*[198] This may cause injustice in some cases. On the other hand, the effect of applying the new restriction only means that a buyer will not have a right of rejection, but he can still claim damages. This can do more justice than the all-or-nothing approach. We therefore recommend that non-consumers' rights to reject under section 32 should be restricted in the same way as their rights to reject under sections 14 to 17 as recommended in Chapter 7. For this purpose, we further recommend adopting section 30 (2A) and (2B) of the 1979 Act of England.

Recommendation 27

We recommend that provisions should be made in section 32 of Cap 26 to restrict non-consumers' rights of rejection on delivery of a wrong quantity similar to those in section 30(2A) and (2B) of the English Sale of Goods Act 1979, namely:

(a) a non-consumer cannot, in a case of shortfall under section 32(1), reject the goods delivered, or in a case of excess under section 32(2), reject the whole of the goods delivered, if the shortfall or excess is so slight that it would be unreasonable for him to do so;

(b) the burden is on the seller to show that the shortfall or excess is so slight that it would be unreasonable for the buyer to repudiate the contract, and that the buyer does not deal as a consumer.

Acceptance of goods

9.128 Section 37 of Cap 26 provides for acceptance of goods and reads as follows:

> *"(1) Subject to subsection (2), the buyer is deemed to have accepted the goods-*
>
> *(a) when he intimates to the seller that he has accepted them; or*
>
> *(b) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller.*

[198] P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 107.

(2) Where goods are delivered to the buyer, and he has not previously examined them, he is not deemed to have accepted them under subsection (1) until he has had a reasonable opportunity of examining them for the purpose-

(a) of ascertaining whether they are in conformity with the contract; and

(b) in the case of a contract for sale by sample, of comparing the bulk with the sample.

(3) The buyer who deals as consumer cannot lose his right to rely on subsection (2) by agreement, waiver or otherwise.

(4) The buyer is also deemed to have accepted the goods when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them.

(5) The questions that are material in determining for the purposes of subsection (4) whether a reasonable time has elapsed include whether the buyer has had a reasonable opportunity of examining the goods for the purpose mentioned in subsection (2).

(6) The buyer is not by virtue of this section deemed to have accepted the goods merely because the goods are delivered to another under a sub-sale or other disposition."

9.129 According to section 37, a buyer will be deemed to have accepted the goods if he intimates this to the seller or does something inconsistent with the seller's ownership. He will also be deemed to have accepted the goods if a reasonable time has lapsed after his retaining of the goods.

9.130 Section 37 also clarifies that a buyer is not deemed to have accepted the goods unless he has had a reasonable opportunity to examine them (subsection (2)), or merely because the goods are delivered to another under a sub-sale or other disposition (subsection (6)). However, it remains unclear whether a buyer's attempt to remedy the defective goods or to have them remedied by the seller or another would amount to an inconsistent act or intimation of acceptance under section 37(1). Nor is it clear whether the time spent in repairing would count towards the running of "a reasonable time" under section 37(4).

9.131 Section 35(6)(a) of the 1979 Act has made it clear that a buyer is not deemed to have accepted the goods *"merely because …he asks for, or*

agrees to, their repair by or under an arrangement with the seller …"[199] Academics generally favour this clarification. Brian Childs has said that the new section 35(6)(a) "introduces a welcome declaration".[200] Professor Bridge has said that the new section 35(6)(a) puts the issue "beyond any doubt".[201] Professor Atiyah in commending the amendment has mentioned:

> *"It used not be clear what effect attempts to remedy defects might have on the buyer's right to reject in these consumer cases. It is, of course, the normal response of the parties where defective consumer goods are sold for the buyer to demand that they should be repaired. …The new provisions, at all events, dispose of this point, because they contain the new s35(6)(a) which provides that the buyer is not deemed to have accepted the goods merely because he asks the seller for the goods to be repaired."*[202]

9.132 We agree with the Law Commission that frequently buyers are happy to have the defective goods repaired by the sellers, although they may be entitled to reject the goods. Even though we decline a formal statutory cure regime, we do encourage informal attempts to cure and we recommend adopting section 35(6)(a) of the English 1979 Act. Otherwise, the situation would be as the Law Commission has said:

> *" …buyers would be best advised not to allow the seller to try to put the goods right, but to insist on rejecting the goods and to claim their money back even where the seller was willing to repair the goods. This does not seem a reasonable state for the law to be in …"*[203]

9.133 As to whether the time spent in repairing would count towards the running of "a reasonable time" under section 37(4), the Law Commission has stated:

> *"it is not necessary to amend the Sale of Goods Act to deal with the point. The Act already states that what is a reasonable time is a question of fact [section 59]. It is therefore open to a court to take into account time spent in attempting to cure goods. If the [Act] is to be amended …to make it clear that attempts at cure do not of themselves amount to acceptance, we do not think that a court would count time taken in repairing the goods when deciding whether or not a 'reasonable time' had elapsed."*[204]

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199 For unknown reasons, the Sale of Goods (Amendment) Ordinance 1994 has not adopted this provision.

200 B Childs, "Goodbye to all that?", (1995) 46 NILQ 232, at p 237.

201 M Bridge, *The Sale of Goods*, 1997, at p 171.

202 P Atiyah, *The Sale of Goods*, 9th Ed, 1995, at p 471.

203 Law Com No 160, 1987, at para 5.27.

204 Law Com No 160, 1987, at para 5.31.

9.134 Professor Bridge has also endorsed this view:

> "*[s]ection 35(6)(a) does not expressly suspend time while repairs are being attempted though this seems a reasonable inference to make. The Law Commission initially recommended such an express provision but prudently drew back from the statutory complexities that a perusal of the new section 35 shows would have been inevitable.*"[205]

9.135 Like its English counterpart, section 58 of Cap 26 also provides that "what is a reasonable time is a question of fact". We agree that there is already adequate flexibility for courts to decide what is reasonable time in each case and to disregard the time taken in repairing the goods. We therefore conclude that there is no need to spell this out in the legislation.

Recommendation 28

We recommend that section 37 of Cap 26 should clarify that a buyer shall not be deemed to have accepted the goods merely because he asks for, or agrees to their repair by or under an arrangement with the seller.

A reasonable opportunity of comparing the bulk with the sample

9.136 In Chapter 7, we recommend restricting non-consumers' rights to reject goods in case of slight breaches of the statutory implied conditions. It is hard to see how a failure to provide a reasonable opportunity to compare the bulk with the sample under section 17(2)(b) of the Cap 26 can be said to be a "slight breach". A "reasonable opportunity" is not a matter of degree.

9.137 The same issue also arose in England and Wales, and the Law Commission recommended transferring section 15(2)(b) of the 1979 Act (equivalent to section 17(2)(b) of Cap 26) to section 34 (equivalent to section 36 of Cap 26).[206] The Sale and Supply of Goods 1994 Act implemented this recommendation.

9.138 The question is whether it is appropriate to move section 17(2)(b) to section 36(2) of Cap 26 which provides as follows:

> *"Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the*

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[205] Michael Bridge, "Commercial Sales - The Sale and Supply of Goods Act 1994" [1995] JBL 398, at p 407.

[206] Law Com No 160, 1987 at para 6.28.

purpose of ascertaining whether they are in conformity with the contract."

9.139 The transfer of section 17(2)(b) to section 36(2) would mean that Section 17(2)(b) would no longer be an implied condition. Professor Reynolds has mentioned that the right, arising on a buyer's request, imposes an obligation on a seller for breach of which the buyer, if he could prove loss,[207] could claim damages. Professor Bridge, on the other hand, has said that the section makes no mention of the sanction for non-compliance.[208] Both share the view that a right of examination is a condition precedent to a buyer's duty to accept the goods. Thus, if a seller refuses the buyer an opportunity to examine, the buyer is not obliged to accept the goods.

9.140 What is sure is that consequent upon the transfer of section 17(2)(b) to section 36(2), the provision will no longer be an implied condition. While acknowledging that the provision will no longer be an implied condition, the Law Commission was of the opinion that there should not be any substantial alteration in the law.[209]

9.141 It is clear that the remedy for a breach of an implied condition is a right of rejection, but, as discussed above, the sanction for non-compliance with section 36(2) after the proposed transfer is uncertain. In addition, while section 11(2) and (3) of Cap 71 prohibits any contracting out of section 17(2)(b), it is not clear whether Cap 71 would prohibit any contract term which contracts out of the new section 36(2).

9.142 If the purpose of the transfer is merely to bring section 17 more in line with the restriction on non-consumers' rights of rejection proposed in Chapter 7, the uncertainty brought about by the transfer is not well justified. The provision restricting non-consumers' rights of rejection in the Recommended Legislation could simply specify that it applies to "section 17(2)(a) and (c)" but not "section 17". We therefore make no recommendation.

Concluding observations

9.143 The law relating to consumer protection in Hong Kong is found in a number of different ordinances. These include:

(a) the Sale of Goods Ordinance (Cap 26);

(b) the Control of Exemption Clauses Ordinance (Cap 71);

(c) the Unconscionable Contracts Ordinance (Cap 458);

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207 Provided that the loss is different from that consequent upon general failure to perform the contract. *Benjamin's Sale of Goods,* 5th Ed, 1997, at para 12-039.

208 Bridge, *The Sale of Goods*, 1997, at p 165.

209 Law Com No 160, 1987, at para 6.28.

(d) the Supply of Services (Implied Terms) Ordinance (Cap 457);

(e) the Consumer Goods Safety Ordinance (Cap 456);

(f) the Toys and Children's Products Safety Ordinance (Cap 424);

(g) the Trade Descriptions Ordinance (Cap 362);

(h) the Weights and Measures Ordinance (Cap 68).

9.144 If the Recommended Legislation is enacted, there will be one more item to add to this list. There is no comprehensive code providing for consumer protection in Hong Kong.[210]

9.145 We notice that the 1974 Act in Australia provides[211] protection to consumers against unconscionable conduct, false representations and other "unfair practices" in relation to the supply of goods and services. It also provides adequate remedies in the case of defective goods or inadequate services. The 1974 Act is regarded as playing "*a central role in the development of Australian consumer protection law*".[212] We are of the view that this may be, at least in part because it provides in a single statute a comprehensive set of provisions covering various aspects of consumer protection and enables the public to have easier access to the law.[213]

9.146 We take this opportunity to observe that we believe that consideration should be given to consolidating consumer protection provisions within a single statute. A consolidated statute could significantly enhance the law's accessibility and make it easier for the public, especially consumers to determine their rights and liabilities.

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210 Cap 26 is more comprehensive but it is still not a code of sale of goods. In any event, it regulates only sale of goods but not other modes of supply of goods.

211 It also regulates restrictive trading practices with the aim of preventing monopolistic and anti-competitive practices among traders, and achieving greater competition and efficiency in markets.

212 Clive Turner, *Australian Commercial Law*, 21st Ed, 1997, at p 320.

213 One of our Sub-committee members has a different view on the 1974 Act. He is of the opinion that the law of contract and law of tort are subsumed within the 1974 Act which is attempting to be all-inclusive, since causes of action founded on the common law and equity are only pleaded in the alternative. Secondly, the Australian Competition and Consumer Commission, which administers the 1974 Act, is entrusted with constitutionally disturbing powers. Thirdly, there are still plenty of areas of uncertainties in the 1974 Act. However, he also finds that a consolidated statute should be of use to both consumers and non-consumers.

Annex 1

COMPARISON TABLE OF STATUTORY IMPLIED TERMS IN CONTRACTS FOR THE SALE AND SUPPLY OF GOODS

Jurisdiction	*Type of contract*	*Statute*	*Title/ possession*	*Correspondence with Description*	*Merchantable Quality*	*Fitness for Purpose*	*Correspon-dence with Sample*
Australia (Commonwealth)	Supply of goods[1]	Trade Practices Act 1974	s 69	s 70	s 71(1)	s 71(2)	s 72
Hong Kong	Sale of goods	Sale of Goods Ordinance (Cap 26)	s 14	s 15	s 16(2)	s 16(3)	s 17
New Zealand	Supply of goods[2]	Consumer Guarantees Act 1993	s 5	s 9	s 6 & s 7[3]	s 8	s 10
England & Wales	Sale of goods	Sale of Goods Act 1979	s 12	s 13	s 14(2)[4]	s 14(3)	s 15
	Transfer of property in goods other than sale or hire-purchase	Supply of Goods and Services Act 1982	s 2	s 3	s 4(2)[4]	s 4(4)	s 5
	Hire-purchase	Supply of Goods (Implied Terms) Act 1973	s 8	s 9	s 10(2)[4]	s 10(3)	s 11
	Hire	Supply of Goods and Services Act 1982	s 7	s 8	s 9(2)[4]	s 9(4)	s 10

1 "Supply" is defined, in relation to goods, as including supply by way of sale, exchange, lease, hire or hire-purchase in s4, Trade Practices Act 1974.
2 "Supply" is defined, in relation to goods, as meaning supply by way of gift, sale, exchange, lease, hire or hire-purchase in s2, Consumer Guarantees Act 1993.
3 The term "acceptable quality" instead of "merchantable quality" is used.
4 The term "satisfactory quality" instead of "merchantable quality" is used.

Annex 2

CONSUMER COUNCIL

(1) COMPLAINT STATISTICS ON HIRE OF GOODS

(The complaints were mainly about hire of videotapes and wedding dresses).

Nature of Complaints	*1998*	*1999*	*1-7/2000*
Improper Practices	49	13	0
Late/Non-delivery/Loss	0	3	1
Charges Dispute	19	9	6
Quality Of Goods	2	0	0
Quality Of Services	22	7	1
Advertisement	1	0	0
Shop Closing Down	0	2	0
Others	40	3	5
Total	**133**	**37**	**13**

(2) COMPLAINT STATISTICS ON HIRE PURCHASE OF GOODS

(The complaints were mainly about hire purchase of electrical appliances.)

Nature of Complaints	*1998*	*1999*	*1-7/2000*
Charges/Interest Dispute	23	17	15
Quality Of Goods	0	1	0
Quality Of Services	1	0	0
Others	4	0	0
Total	**28**	**18**	**15**

/ …Annex 2

Annex 2

(3) COMPLAINT STATISTICS ON CONTRACTS FOR WORK AND MATERIALS

(The complaints were mainly about custom-made furniture and decoration work for residential properties).

Nature of Complaints	*1998*	*1999*	*1-7/2000*
Improper Practices	4	8	6
False Descriptions	18	17	5
Late/Non-delivery/Loss	79	103	56
Charges Dispute	16	24	7
Quality of Materials	250	365	239
Quality of Services	81	69	45
Repair/Maintenance Services	2	5	4
Wrong-model	13	23	30
Shop Closing Down	5	21	7
Others	17	16	14
Total	**485**	**651**	**413**

Annex 3

CONSUMER COUNCIL
COMPLAINT STATISTICS ON COMPUTER SOFTWARE

Nature of Complaints	*1996*	*1997*	*1998*	*1999*	*1-10/2000*
Sales Practices	3	4	1	3	1
False Trade Description	0	0	1	0	1
Installation	0	0	1	0	0
Late/Non-Delivery/Loss	4	1	5	4	2
Price Dispute	1	1	0	1	0
Quality of Goods	6	8	6	9	8
Quality of Services	1	1	3	1	3
Spurious Goods	0	0	1	0	0
Wrong-Model	0	1	0	0	0
Others	3	2	7	4	5
Total	**18**	**18**	**25**	**22**	**20**